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# HALLGARTEN & COMPANY

## Conjectural Corporate Action

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# HudBay/Thompson Creek (TSX: HBM/TCM)
# A Merger to Make a Major?

| HudBay | | |
|---|---|---|
| Price (CAD) | $ 7.89 | |
| 12-Month Target Price (CAD) | $ 9.00 | |
| Upside to Target | 14% | |
| High - Low (12 mth) | $7.36-12.10 | |
| Market Cap (CAD mn) | $ 1,359.6 | |
| Shares Outstanding (millions) | 172.3 | |
| | **2012** | **2013e** |
| Consensus EPS | | $0.11 |
| Hallgarten EPS | | n/a |
| Actual EPS | $0.73 | |
| P/E | 10.7 | 71.7 |
| Dividend | $ 0.20 | $ 0.10 |
| Yield | 2.5% | 1.3% |

| Thompson Creek | | |
|---|---|---|
| Price (CAD) | $ 3.52 | |
| 12-Month Target Price (CAD) | $ 6.00 | |
| Upside to Target | 70% | |
| High - Low (12 mth) | $4.49-2.23 | |
| Market Cap (CAD mn) | $ 761.4 | |
| Shares Outstanding (millions) | 216.3 | |
| | **2012** | **2013e** |
| Consensus EPS | | $0.17 |
| Hallgarten EPS | | $0.12 |
| Actual EPS | ($3.24) | |
| P/E | n/a | 29.3 |
| Dividend | n/a | n/a |
| Yield | 0.0% | 0.0% |

# HudBay/Thompson Creek

## A Merger to Make a Major?

- + HudBay is still majorly cashed up despite splurging on Norsemont
- + Current low valuation of TC aids in expediting a deal and focusing shareholders' minds
- + A merged entity would be strong in copper, zinc, lead, silver, gold and molybdenum, giving a good spread of metals exposure to diversify risk
- + The Mount Milligan Copper/Gold project of TC is very advanced with commercial production expected before year end
- + A merger between TC and HudBay would create a new Canadian major to fill the space left empty a decade ago by the disappearance of Noranda and Falconbridge
- + Debt of TC (the 9.75% coupon paper) could be refinanced lower after a deal
- ✘ Thompson Creek is a beaten down stock, paying the price of having had the foresight to diversify into copper with Mt Milligan
- ✘ The Constancia purchase by HudBay was expensive and capital-hungry

**Musing On What Makes Sense**

There is a class of bankers that make large amounts of money from either stating the obvious (suggesting deals that should be already apparent to any sort of relatively competent management) or from taking improbable and barely logical transactions and cloaking them in some mathematical garb (e.g. Kinross buying Red Back Mining) that convinces clueless managements that these bankers should be hired to prosecute (and explain) the transaction to skeptical shareholders and the marketplace.

If we have our choice then we would far prefer the innately sensible deal (the one that generates the "gee, why didn't I think of that" response) over the "huh??" type of proposal. When a colleague recently said to us that we should consider what a TC/HudBay match-up might look like our immediate response was "wow" and so we have here applied ourselves to the hypothesis and present our findings.

**Plodding Along**

HudBay has a long history as a plodder. Its sole attempt to break out of this mold was particularly ill-timed and involved a bid for Lundin Mining at the darkest hour in 2008 for mining share prices and base metals prices. The deal came to grief upon investor objections and the HudBay management were required to commit hara-kiri to atone for their sins. The company then became a prodigious cashbox.

In retrospect it looks like the idea of putting Lundin together with HudBay may not have been all that bad after all. Certainly though the failure of the deal prompted the eventual sale of the Lundin stake for a sizeable (over CAD$100mn) gain for Hudbay.

HudBay is an institution in the largely depleted mid-tier space in Canada. After its failed Lundin merger it had the look of a museum specimen of what a diversified miner on Bay Street looked like for decades.

The carnage in the ranks of major Canadian miners left HudBay as a lonely survivor, with Teck and Inmet being its only “lookalikes” out there.

The company was founded over 80 years ago and has mainly had a focus on base metals. Recent years have been a transitional period with several major assets having run the course of their natural lives and several new production assets being still in construction (or suspension thereof). We shall discuss these anon.

**The Lundin takeover**

While it was some while ago now it is useful to look at this transaction as its reverberations still echo with actions (and reactions) taken at that time continuing to dictate the course of events.

Ostensibly when Hudbay announced its agreed offer for Lundin in November 2008 it was a takeover as per the conventional meaning of the word. Almost straight away a little-known group, Jaguar Financial, appeared on the scene with a vague counter-offer. As we all well know Canadian boards disapprove of hostile bids, because they may empower the shareholders at the expense of the corporate PTBs. Thus Jaguar was dismissed rapidly and all focus turned to the “favoured” bid.

When we first saw the Lundin bid it had the distinct look of a quasi-rescue of the overstretched Lundin, that would eventually result in the Lundin crew ending up on top around at Hudbay. Every transaction has its merits in the eyes of someone or other but to us the whole Canadian world of agreed bids is so dubious, and so shareholder-unfriendly, that we interpret any agreed bid as suspect until proved otherwise. Unlike the usual Canadian corporate action though, the offer got up the dander of some institutional investors who, led by the hedge fund SRM Global Master Fund Limited Partnership, put up a spirited challenge and launched a campaign to derail the offer. Surprisingly enough they succeeded and on the 23rd of February 2009, HudBay announced it had cancelled the offer and eventually it unwound its 19% holding Lundin by placing the stake in the market in May for a sizeable gain of over CAD$100mn.

**The Night of the Long Knives**

The plan to merge Hudbay with Lundin (via the former taking over the latter) smelt of rescue when it was proposed in late 2008. Not only was it a rescue but it had the rescued seemingly come out on top. Torpedoing the deal was seemingly not enough for SRM, the leader of the dissident shareholders, went after Allen Palmieri, the then CEO of Hudbay and managed to make off with his scalp on the 10th of March when he resigned. Then the interim CEO of HudBay named in his place was Colin Benner. Maybe it should have come as no surprise as Colin Benner was a Lundin alumni. We had come across him on our previous travels as a player around at Creston Moly, amongst others. Not content with this displacement SRM came up with a slate of directors to represent the dissident forces and began pushing the slate for the shareholders meeting, to be held on the 23rd of March 2009. Despite the incumbent board managing to get some proxy services to advocate their maintenance in power, the shareholders ousted the board and a flock of SRM nominees took their place. We were to compare this new crew to a collection of Cigar Store Indians, after their sheer lack of movement during one of the greatest bargain basement sale in the industry’s history made us wonder if they were actually still living and breathing.

**Meanwhile, Back at the Farm**

How the mighty are fallen… In the days of $30 Moly, TC was a rock-star with a multi-billion dollar market cap and a frenzied trading activity on the New York Stock Exchange. The undoing of TC was twofold. Moly prices strangely never recovered well from the 2008 slump. While copper moved on to hit new highs Moly became more like Nickel and Zinc, a metal pining for better days back mid-decade when ramping hedge funds had artificially pumped up prices. Moly never saw $20 again let alone $30 and with its travails, TC slumped and wallowed.

The second blow came from TC's attempt to break out of the orbit of Moly alone. It decided to go for a more binary solar system in the form of copper. Not a bad concept but the execution left something lacking. Essentially, while Terrane was not a very expensive deal compared to TC's then market cap, it was a big deal in terms of future capex commitment. To fund this TC had to more aggressively milk its existing assets (i.e the Moly mines). Ideally, the company should have been reducing Moly output to give the metal price a bit of a kick-start but instead TC found the capital demands required more production not less. Debt burdens and financing fears sunk the stock price thus compounding the financing problems. This is what has brought TC to its current sorry pass.

The background to all this is that Thompson Creek Metals was first incorporated as a private company in Canada in 2000. On October 26, 2006 it was acquired by TSX-listed Pearl Mining Ltd for $575 million US, in addition to other payments worth as much as $125 million US depending on the price of molybdenum. Blue Pearl Mining Ltd then renamed itself Thompson Creek Metals Company Inc. in May 2007. Though all operations (as of late 2010) involve the mining and processing of molybdenum, many of the company's projects also contain significant copper and gold reserves.


In its early days the Moly price topping $30 was a major motor for the stock. When the ground fell away beneath the metal in the wake of 2008, the stock suffered disproportionately plunging to lows in 2009 that it has only managed to match in recent weeks. While Moly prices and the generalized mining malaise played their part it is more the debt situation and challenges of finishing Mt Milligan that have weighed on the stock price.

**Making Sense**

As we have noted many times, the best phrase we might use to describe the Toronto mining market is “opportunities lost”. While boosters would claim (until recently) that the Canadian mining finance markets are (or were) the most efficient and successful in the world, we would beg to differ. In the process of all this “efficiency” the market has “lost its head” in the form of the capture of Falconbridge, Noranda and INCO by foreign interlopers, leaving Teck, Sherritt (the perennial pariah), Lundin and Inmet (or should we now say First Quantum?). While the last transaction sent a frisson through what is left of the Toronto mining grandees it was exactly the type of deal that would have saved the Canadian mining establishment from annihilation in the middle of the last decade. HudBay is the best (quasi-) living example of opportunity missed when its chance to use its enormous war chest of cash in the wake of the 2008 crash was ignored, as management stood like deer in the headlights and firmly refused to part with a cent (until all the bargains had gone).

Now we might argue that opportunity has come knocking again in the form of the current slump. This slump is even better for moneyed miners for in 2009 not only values were down but so were the commodities that the miners aimed to produce. In the current context though, the miners are marked down and an acquirer knows that they can at least get $1,400 for an ounce of gold that a target might produce or, in this case, at least $3 per lb for copper produced. Thus HudBay bingeing on an acquisition would not be as daring now as it would have been in early 2009.

Casting a wide net for potential targets would bring a lot of fish to the boat but not a few of them would be rotten and need tossing back. Does HudBay need another new-build project at this juncture? We would say not. So hunting for a target that makes a difference and is producing is not as easy a task as one might imagination. With Capstone bulking up with the Pinto Valley buy and First Quantum consuming Inmet, we stand potentially on the cusp of an era in which new majors are created. Capstone is not quite there yet but another deal (buying Revett Minerals, Mercator Minerals or suchlike) would put it in the big leagues. First Quantum is obviously now a major and shall spend some time digesting what it picked up.

So what is there out there that would be transformative for HudBay? The most obvious target that comes to mind is Thompson Creek Metals. We shall discuss further this theme, along the TC asset mix but here we would say that it meets quite a number of criteria for an attractive stock-only merger. Those elements are:

- Inexpensive, due to battered share price
- Uninspiring Senior Management
- Large copper/gold (Mt Milligan) mine coming on-stream shortly
- Substantial existing cash flow
- Existing moly roaster in the US
- Debt-stressed

To put Thompson Creek into perspective, the company now has a market capitalization that is LESS than that of the advanced explorer, Norsemont which was still lacking the $1.5bn in CapEx that was needed to be spent. In contrast TC comes with two operating mines, a roaster and an advanced copper/gold property that should be in production this year. While we might indulge in "pity HudBay hadn't waited" we might also say that TC has been getting cheaper by the day and it is a better deal to buy TC at this point, bolt on all its production to HudBay's output and slow track Constancia, funding it out of cashflows.

**Deal Pricing**

The current market capitalization of HudBay is $1.43bn while TC's is a mere $761mn (when taking the tMEDS into consideration). We dare say that to make this a slam-dunk, HudBay would have to pay up somewhat (and we reiterate again, only pay with stock). A calculation that puts something like a $1bn valuation on TC should win the day. That would be a healthy premium to the current price and as it's an all-stock deal it will not be as if TC holders are being tossed off the train. The commercial logic of combining so many major-mines (Flin Flon 777, Mt Milligan, Lalor, Endako, Thompson Creek, Reed and eventually Constancia) together with the cash-horde of HudBay is compelling indeed. The new entity would even trump the First Quantum/Inmet combine and give Canada another major made out of two rather nondescript mid-tier players. It also spans a wider range of metals (copper, moly, lead zinc, gold, silver and even nickel potentially) than a player like Teck for example and starts to fill the shoes left empty by the departure from the scene of Noranda so many years ago.

**The tMEDS complication**

Thinking about Thompson Creek's series of 6.5% Tangible Equity Units made us wonder if this had originally been conceived as some sort of poison pill. These were issued only a year ago in May 2012 and it consisted of an offering of 8,800,000 of its 6.50% tangible equity units (known as "tMEDS"), each with a stated amount of $25. The issue generated net proceeds of approximately US$212mn. Of the US$220mn aggregate stated amount of tMEDS, approximately US$177.5mn will be accounted for as equity and $35.9 million will be accounted for as debt.

Each tMEDS is a unit composed of a prepaid stock purchase contract and a senior amortizing note due May 15, 2015. Each purchase contract will automatically settle on May 15, 2015 for between 4.5855 and 5.3879 shares of Thompson Creek common stock, subject to adjustment by a formula specified in the prospectus. The amortizing notes will pay equal quarterly installments of $0.406250 per amortizing note, which will constitute a payment of interest and a partial repayment of principal, and which in the aggregate will be equivalent to a 6.5% cash payment per year with respect to each $25 stated amount of tMEDS. The amortizing notes are classified as senior unsecured obligations of the company.

By our calculations this implies that another 33 mn shares might be added to TC's share count at that point in May 2015.

**HudBay's Asset Spread**

For a mid-tier miner with substantial resources, Hudbay has rather a narrow spread of assets. The reason it is not as well-known as Teck is that it was primarily a “stay-at-home mom” of the mining scene never venturing far from the safety of the mother country. The only daring part of its portfolio before 2008 was its Guatemalan exposure, which surprisingly ranks as pretty daring considering how few others have been tempted to deal with the less than straightforward Guatemalan situation. Its next excursion overseas was the Norsemont purchase in 2011, which in some ways made HudBay look like an innocent abroad in over-paying for an asset it could have acquired earlier for much cheaper, or then again it could have acquired even better producing assets back in 2009 rather than projects it had to develop itself in unfamiliar territory.

**Flin Flon**

The amusingly named mining district contained two of HudBay’s major assets. These are the currently producing “777” mine and the former Trout Lake mine. The main geologic feature of the zone is the Flin Flon greenstone belt.

The main producer is the “777” mine which produces zinc, copper, gold and silver. Its output is around 1,490,00 tonnes of ore per annum The estimated life of mine is until 2021. In 2010, HudBay began a $20 million program called the 777 North expansion, which involves driving a ramp from the surface to the 440-metre level to access zinc and copper zones and facilitate the development of an underground exploration platform to evaluate further exploration opportunities. Upon completion, the 777 North expansion is expected to supply additional ore feed to the Flin Flon concentrator and zinc plant. Production is expected to be at a rate of 330 tonnes per day.

The Trout Lake mine was HudBay’s most long-lived asset having been in production for 28 years when it finally closed down in December of 2012.

**Lalor**

Then there is Lalor which seems to be Hudbay’s Great White Hope as other mines mature and start to run down. Lalor is a 100%-owned volcanic massive sulphide deposit located in Snow Lake, Manitoba. It is located 15 kms from Hudbay’s existing Snow Lake concentrator

Located three kilometres from the now closed Chisel North mine, the Lalor project is HudBay’s next major underground mine. The primary metals to be exploited are gold, zinc and Copper with silver as a secondary output. The project is believed to hold the second-largest metal deposit in the Flin Flon Greenstone Belt and the largest pre-development deposit discovered in the Flin Flon-Snow Lake region.

The deposit has seen drilling of around 154,000 metres of diamond drilling in in 146 holes to date. The NI 43-101 dated September 30, 2011, produced the resource below:

| Lalor - Resource | | | | | | |
|---|---|---|---|---|---|---|
| Zone | Category | Million Tonnes | Au (g/t) | Ag (g/t) | Cu (%) | Zn (%) |
| Base Metal | Inferred | 3.817 | 1.2 | 22.15 | 0.6 | 9.09 |
| Gold Zone | Inferred | 7.338 | 4.64 | 31.35 | 0.41 | 0.32 |
| Copper-Gold Zone | Inferred | 1.461 | 6.8 | 20.33 | 4.15 | 0.31 |
| Total | Inferred | 12.616 | 3.85 | 27.29 | 0.9 | 2.97 |

Besides the base metal resource HudBay's team also made a discovery of gold mineralization in a separate zone. Some of the gold grades were such (e.g. 8.75m at 23.11 g/t and 13m at 10.28 g/t) that Hudbay speculated that this part of the property could be developed as a base metals mine with principal gold credits. As the resource above shows, gold turned out to be a significant part of the mix.

Initial production at the Lalor mine, located in the Chisel Basin of the Flin Flon Greenstone Belt, began in August 2012. The ore will be processed at the nearby Snow Lake concentrator until completion of the production shaft and new concentrator expected in late 2014. The first full year of production from the production shaft is expected in 2015.

Key metrics for the mine are:

- ✓ Production rate: 4,500 tonnes per day
- ✓ Projected life of mine: 20 years
- ✓ Capital costs: (2010 to 2015): $794 million
- ✓ Annual sustaining capital expenditures: $22 million
- ✓ Estimated mining cost: $36 per tonne
- ✓ Estimated milling cost: $16 per tonne

Thus far (up until the end of March 2013) the company has invested approximately $338 million of the eventual $794 million capital construction budget for the Lalor project and has entered into an additional $84 million in commitments for the project.

Hudbay refers to three phases of the Lalor project when determining commercial production for accounting purposes. The first phase of the project includes the main ventilation shaft and associated surface and underground workings that will contribute to the production of ore between 2012 and 2014. Hudbay commenced this phase of commercial production on April 1, 2013 with Lalor initial production contributing to profit starting at that time.

During the first quarter of 2013, Hudbay hoisted 81,800 tonnes of ore from the ventilation shaft at Lalor at a copper grade of 0.57% and zinc grade of 9.94%. During the same period, underground project development continued to advance. The company's primary focus is to complete the 910 metre shaft station in the second quarter of 2013 and to continue to ramp to the 955 metre level, which the company expects to reach by the end of the third quarter of 2013. Hudbay is developing ore and waste handling systems as well as the dewatering areas on the 910 and 955 metre levels.

As of April 26, 2013 the main production shaft was sunk to approximately 710 metres and is approximately 72% complete. Hudbay expects shaft sinking to be completed in late 2013. Upon completion of sinking, the installation of the steel sets and guides as well as the headframe changeover will begin. Ore production is expected to transition from the ventilation shaft to the main production shaft by the fourth quarter of 2014, subject to receipt of required regulatory permits.

Hudbay is in the process of completing the final engineering work for the load‑out facilities located at the 955 metre level, as well as the main pumping installations. The company is preparing for construction of the main intake fan systems and the main substation, which is scheduled to be completed in the fourth quarter of 2013.

Hudbay expects to submit the Environment Act Licence application for the new concentrator to the Manitoba government in the second quarter of 2013. The new design will incorporate a larger grinding circuit being fed from the surface stockpile. Hudbay will hoist uncrushed ore up the main production shaft at Lalor to be crushed on surface and then conveyed to the surface stockpile. The stockpile will feed a SAG mill and ball mill combination that has design capacity of 5,400 tonnes per day.

Lalor gives a major extension of collective mine-life to the Flin Flon region which has been pretty much a HudBay bailiwick for decades.

**Reed**

This high-grade copper deposit is surprising for being both very small in production terms and in mine life. This mine is also located in the Flin Flon Greenstone Belt, is expected to begin production by late 2013. Annual copper production in concentrate from the Reed mine is expected to average 17,000 tonnes over a five-year mine life.

**Aquila' Back Forty – Mere Dabbling**

The only transaction that Hudbay engineered in the immediate aftermath of it's 2009 changing of the guard left us underwhelmed when it was announced. This was that HudBay had entered into an agreement with Aquila Resources (AQA.to) granting HudBay the right to acquire a majority interest in Aquila's Back Forty.

The Back Forty Project Project located in Menominee County, Michigan was discovered in 2002. It was at the time an advanced exploration-stage volcanogenic massive sulfide deposit containing zinc, gold, copper and silver. An NI 43-101 compliant resource estimate from January 2009 showed 8.5 million tonnes in the measured and indicated category and an additional 1.2 million tonnes in the inferred category. Much of the deposit was said to be mineable using open pit methods, which could allow for faster, lower cost mine development compared to underground mining. The project also includes an exploration land package of approximately 9,600 acres.

At that time we had wanted Hudbay to do medium-sized deals instead of transformative big deals, but the Aquila transaction was heading in totally the opposite direction with an investment so small as to be almost a rounding error. Under the agreement, HudBay agreed to subscribe for 12,141,051 common shares (at a price of CAD$0.1827 per share) of Aquila giving it a 14.9% ownership interest. This represented an investment of CAD$2.2mn (out of the then $800mn plus cashpile).

HudBay also obtained an option to acquire a 51% ownership interest in Back Forty through the expenditure of US$10mn within three years and the right to further increase its ownership to 65% by completing a feasibility study, submitting an application for permitting the project and making certain option payments. HudBay was the operator for the joint venture and gained marketing rights to the metal production from the project. However as of the 3rd of July 2012 HudBay suspended funding for the joint venture. Latest word from Aquila was that both parties are "working together to assess various strategic alternatives that will continue to advance the project and that are in the best interests of shareholders and stakeholders".

**Refineries – the baggage of history**

One should not forget that the original name of HudBay was the Hudson Bay Smelting and Refining Company. The company has long been committed to the virtues of vertical integration from mine to ingot. The downstream assets at HudBay are:

- the Balmat zinc concentrator/smelter in upstate NY (under LOI for sale)
- the White Pine copper refinery in Michigan (shuttered)
- the Flin Flon copper smelter in Manitoba (rebuilt)
- the Flin Flon zinc plant (modernized)
- the zinc concentrator at Snow Lake, Manitoba (being replaced with a new facility to process Lalor output)

When metals markets are OK, the assets are OK but when metals markets are bad, these assets are truly dire. Of course, processing facilities that are joined at the hip with a mining complex tend to also have a life-cycle that matches that of the mine. A mine closure is usually sudden death for the refinery facility. The Balmat zinc refinery in upstate NY was put into mothballs in 2009 as it did not have a mine to support it any more. Balmat was HudBay's swing producer. Fortunately a buyer seems to have appeared in the form of Beaufeld Resources (BFD.v). In February 2013, Beaufield confirmed that it would acquire all the issued and outstanding shares of the capital of Balmat Holding Corporation, a wholly-owned subsidiary of HudBay Minerals. The parties have signed an exclusivity agreement and a non-binding letter of intent with Hudbay, an arm's length party, to acquire Balmat for payments totalling $12 million and up to $2 million in initial equity of Beaufield. As part of the acquisition, Beaufield will assume the decommissioning and restoration liabilities of Balmat Holding estimated at $20.9 million as at December 31, 2012. The LOI and Exclusivity Agreement give the buyer 90 days to complete its due diligence, negotiate a definitive agreement, and close the acquisition.

The Snow Lake concentrator used to handle the ouput from the now shuttered (Sept 2012) Chisel North mine. In anticipation of the significant increase in production associated with the Lalor project, Hudbay is investing $263 million to construct a new concentrator and paste backfill plant at Snow Lake. The new concentrator will enable an enhanced production rate of 4,500 tonnes per day and allow for an extended mine life. Construction of the concentrator, which is being built adjacent to the previously planned 985-metre production shaft at Lalor, is scheduled for completion in late 2014 to coincide with the completion of the production shaft.

The existing concentrator at Snow Lake was re-started in 2010 after being placed on care and maintenance in January 2009. It processed zinc ore from the Chisel North mine and produces zinc concentrate, which was then shipped by truck for processing at the zinc plant in Flin Flon. The concentrator had a capacity of approximately 1.2 million tonnes of ore per year.

The company's zinc plant at Flin Flon produces special high-grade zinc metal in three cast shapes from zinc concentrate. It is one of three primary zinc producers in North America. The capacity of the zinc plant is approximately 115,000 tonnes of cast zinc per year, and an additional expansion of approximately 15% is possible at comparatively low capital investment. Included in the zinc plant are an oxygen plant, a concentrate handling, storage and regrinding facility, a zinc pressure leach plant, a solution purification plant, a modern electrowinning cell house, a casting plant and a zinc storage area with the ability to load trucks or rail cars. The zinc plant has a dedicated leach residue disposal facility. The bulk of the waste material is gypsum, iron and elemental sulphur. Waste water is treated and recycled through the zinc plant.

Both domestic concentrate produced from HudBay's mines and concentrate purchased from third parties are processed at the zinc plant. The plant currently has excess capacity beyond HBM's domestic concentrate production and the company intends to utilize this capacity by purchasing concentrate and sourcing eventually from its own development projects.

The Flin Flon concentrator produces zinc and copper concentrates from ore mined at the 777 (and formerly the Trout Lake mine). Its capacity is approximately 2.18 million tonnes of ore per year. The Flin Flon concentrator facility includes a paste backfill plant and associated infrastructure. In 2010, HidBay completed a copper concentrate filtration plant and other facilities to allow for the shipping of the copper concentrate we produce. Tailings from the concentrator are pumped to the Flin Flon tailings impoundment immediately adjacent to the concentrator.

HudBay announced in 2010 that it would shutter the White Pine smelter after July 2010. However it had previously quasi-justified its Back Forty purchase from Aquila on the grounds of its White Pine smelter. Maybe one hand did not know what the other was doing.

This ownership of downstream processing seems to colour heavily the decision on which mining properties to pursue with proximity being a major consideration. This is evidenced in the Aquila purchase that was seemingly the only transaction HudBay could pull the trigger on back in 2009 while bargains were lying all over the place.

**Nickel in Guatemala**

HudBay owns 98.2% of the Fenix brownfield nickel laterite project in Guatemala with 41.4 million tonnes of mineral reserves in an open-pit mine. This asset came on board through the merger with Skye Resources (an all-stock deal worth around $450mn) in August 2008. The mine has been mothballed since 1980. The original plan was that the existing 25 million pound per year process plant would be upgraded to approximately 50 million pounds and the process flowsheet will consist of a coal-fired dryer, two calcine/reduction kilns, a 90 MW electric arc furnace, and a ladle refinery to produce a 35% ferro-nickel product. The existing process plant was well maintained and many of the components will be reused. The dryer, one kiln, and the refinery will be new. The existing furnace will be upgraded with new technology to achieve the required capacity.

Production over the 30-year project life was projected to be 1.3 billion pounds of nickel. The average production for the first 20 years after start of full production was planned to be 48.5 million pounds per year of nickel contained in ferro-nickel. The saprolite grades at 1.63% nickel.

Due to the nickel price slump, the company limited expenditures in November 2008 until economic conditions improve, HudBay continues to explore lower cost power supply solutions and transportation options, and to develop infrastructure, such as upgrading the access road. Not much information is available on just how much the rejuvenation of the existing plant will cost.

In light of the difficult reputation Guatemala has (maybe unjustly) the company has busied itself by involving the local community and all levels of government to ensure the project is perceived to benefit the people of Guatemala. Community relations have been not very good with claims that security contractors roughed up (and even killed) locals. This issue relates to interactions between indigenous squatters and personnel of the former owners of the property in the years before HudBay bought Skye. Whatever the case may be HudBay has found itself on the receiving end of no less than three lawsuits brought by NGOs in Ontario courts about the treatment of the locals. This has cast a pall over the project and coloured HudBay's interest in moving the project forward without guarantees from the Guatemalan government. The country has been skating on thin ice for several years now with an accumulation of ill-will between miners and the government and yet another sign of lack of government support for projects may cast the country into the same basket as Venezuela and its ilk.

Hudbay has stated that Fenix is a significant nickel project and a "key growth opportunity" but more is needed to assure us of that than mere platitudes. We are mixed in our nickel sentiments (favouring only Royal Nickel in our Model Mining Portfolio). Fenix is a sizeable proposition and competition from the likes of Vale's mega-projects like Goro churning out product into a rather flat marketplace.

**Norsemont – A Bold Move?**

In early January 2011, HudBay made a move on Norsemont, an advanced explorer with its main project in southern Peru. The company touted the deal as increasing annual copper production by approximately 145% from 2011 levels (by 2016). The slight wrinkle in that calculation was that Norsemont's Constancia project wasn't even built at that time. Norsemont owned 100% of the Constancia copper project which, as at September 2009, had proven and probable mineral reserves containing 277 million tonnes grading 0.43% copper, 0.012% molybdenum, 0.05 g/t gold and 3.7 g/t silver.

The terms of the deal were that Norsemont shareholders would receive 0.2617 HudBay shares and $0.001 in cash, or $4.50 in cash, subject to a maximum aggregate cash consideration of $130 million. The price offered was a premium of 33% over the previous 20 trading days VWAP. The transaction values the equity of Norsemont at approximately $520 million, on a fully-diluted basis. What was not stated was how much HudBay would have paid if it had done the same deal in the lows of 2009 when the company sat on its hands telling the market what a "wise virgin" it was.

Based on the preliminary results of the optimization study released on December 30, 2010, the proposed Constancia project was expected to produce annually 172 million pounds of copper and 2 million pounds of molybdenum in concentrate at attractive cash costs over a 15 year mine life. the Constancia mine is estimated to generate an unlevered internal rate of return of 14.5% and a net present value of US$571 million, assuming a discount rate of 8.0% and long-term copper prices of US$2.75/lb.

In August 2012, Hudbay's board of directors approved a US$1.5 billion investment to fund the development and construction of the Constancia copper mine in Peru. The Constancia development schedule contemplates nine quarters of construction, with initial production in late 2014 and full production commencing in the second quarter of 2015.

Hudbay (up until the end of March 2013) has incurred approximately US$480 million in costs of its US$1.5 billion capex and has entered into an additional US$534 million in commitments for the project.

Development of the project is approximately 25% complete. Civil earth works for the process plant area are approximately 70% complete and remain on schedule. The principal foundations for the ball and SAG mills are poured and complete. Forms are being erected for the reclaim tunnels and crusher foundation. Progress on the tailings management facility has been negatively impacted by the unusually high rainfall in the first quarter. However, the dry season commenced in April and Hudbay believes the impact on project schedule is recoverable. Targets for initial production in late 2014 and full production in the second quarter of 2015 remain unchanged and it expects to begin pre-stripping activities late in 2013.

Land access for the power transmission line is being arranged and the negotiation of the power purchase agreement is well advanced. The principal port operator has provided assurances that the concentrate shipments will be accommodated, and Hudbay is considering short term and long term solutions to best serve the project's needs.

In light of the recent negative publicity surrounding so many mining projects in Peru and their interactions with the local community, HudBay has been rather diligent in this crucial aspect. It entered into agreements with local communities and relocation of affected families is underway with the construction of new housing in progress. Thus far the company has delivered new homes to 14 families, and the remaining 22 families are scheduled to be relocated in 2013. Rather small scale but as a sidebar, we have long been intrigued as to why mining companies do not use housing as a tool to improve community relations. Out of mega-budgets, some breeze-block housing that is substantially better than current ramshackle structures in villages would win no end of local support and cost very little. It makes us wonder why companies do not actually set aside a fixed proportion of the capex to fund local improvements. Too often we see some goats or tree planting as being a sop to local sensibilities. HudBay at least appears to be on the right track here.

**Thompson Creek's Assets**

As we mentioned earlier, TC in its glory days was the result of the forging together of two large Moly mines (one in BC and one in Idaho) and a roaster located in Pennsylvania. Both of its large mines are long lasting with substantial reserves but grades are in decline and mining is becoming tougher with the need to turn three pits at one site into a super-pit. Presumably it was this reality, combined with the extended period of flaccid Moly prices that prompted the company to move in the direction of diversifying into copper with the Terrane purchase.

**Endako**

The Endako Mine is a primary molybdenum mine located near Fraser Lake, 100 miles northwest of Prince George, British Columbia. The mine is operated as a joint venture with Thompson Creek (holding a 75% interest) and the Japanese trading house, Sojitz Corporation (25%).

The mine is a fully integrated facility that began operations in 1965. It includes a concentrator that processes ore through crushing, grinding, and flotation circuits into molybdenum disulfide concentrate, and a multiple-hearth roasting facility that converts the concentrate into technical grade molybdenum oxide.

The Endako Mine consists of three pits; the Endako, Denak West and Denako East. The Endako Pit was the focus of mining activity for many years. In January 2008, mining activity shifted entirely to the Denak West pit and during 2008 the in-pit crusher was moved from the Endako Pit to an area between the Denak West and Denak East pits. The company then began installing an overland conveyor from that location to the mill. The conveyor commenced transporting ore to the mill in March 2009. Plans call for the creation of a super-pit by mining the walls between the three existing pits.

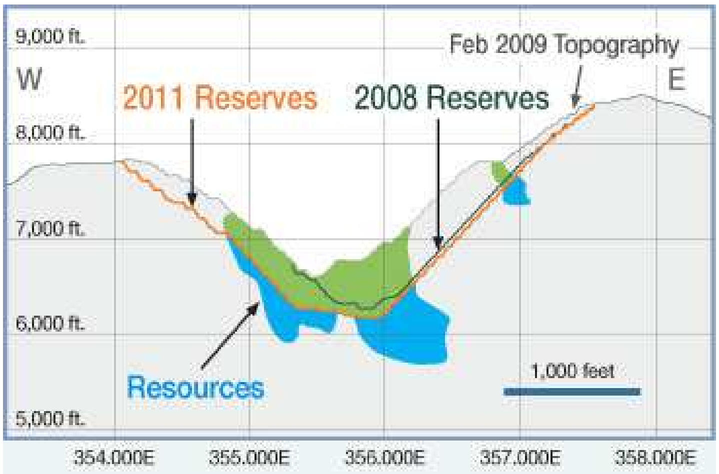
| Endako Mine Category | Tons (millions) | Grade % Mo | Contained Mo (millions lbs) |
|---|---|---|---|
| Measured Resources | 18.9 | 0.029 | 10.9 |
| Indicated Resources | 44.3 | 0.031 | 27.1 |
| Measured and Indicated - Total | 63.2 | 0.03 | 38 |
| Additional Inferred Resources | 54.1 | 0.035 | 37.8 |

In March 2012, the company completed the mill expansion project at the mine. This mill expansion project included the construction of a new mill, replacing the existing mill constructed in the 1960's. The new mill is designed to meet ore-processing capacity of 55,000 tons per day. Commissioning of the new SAG/Ball mill and rougher flotation circuit was completed in early January, followed by ramp-up to commercial production beginning early February 2012. The remaining construction work on the regrind circuit and the pebble crusher was completed in late March. The existing 45-year old mill at the site has been shut down and will be left on care and maintenance.

**Thompson Creek**

The eponymous Thompson Creek Mine is a primary molybdenum mine located in mountainous terrain approximately 35 miles southwest of the town of Challis in Custer County, Idaho. The complex consists of an open pit, mill and tailings facility.

It is the fourth-largest primary molybdenum mine in the world and began operations in 1983. It uses conventional open-pit mining methods with large electric-powered shovels that can each move up to 100,000 tons of waste rock and ore per day. The shovels load ore into 200-ton trucks to be hauled to an on-site mill (concentrator). A molybdenum disulfide concentrate is extracted from the ore through a series of crushing, grinding, and flotation operations.




Daily throughput of ore at the mill averages close to 28,000 tons per day. Most of the molybdenum disulfide concentrate produced at the mine is further processed into technical grade molybdenum oxide at the Langeloth roaster.

In February 2011, Thompson Creek announced new estimates for mineral resources and reserves (see table below).

| Thompson Creek Mine Category | Tons (millions) | Grade % Mo | Contained Mo (millions lbs) |
|---|---|---|---|
| **Measured Resources** | 25.3 | 0.04 | 20.3 |
| **Indicated Resources** | 34 | 0.05 | 34 |
| **Measured and Indicated** | 59.4 | 0.046 | 54.3 |
| **Additional Inferred Resources** | 2.7 | 0.043 | 2.3 |

The mine life calculations are as of January 1, 2011 and assume a molybdenum price of US$12 per pound and updated costs while the Resource calculations are based upon optimized whittle shells using $15 per pound.

**Langeloth**

The Langeloth complex, located 25 miles west of Pittsburgh, Pennsylvania, has a long history of producing high-quality metallurgical products used mainly in the steel and chemical industries. The facility has roasting capacity of 35 million pounds of molybdenum per year. It is the largest ferromolybdenum producer in North America, the first site to commercially convert $MoS_2$ concentrates to technical molybdenum oxide, and the first site to produce pure molybdenum trioxide by sublimation. The site has 147 acres with a solid infrastructure to support additional projects.

The plant has four multiple-hearth furnaces that are used for the conversion (roasting) of molybdenum disulfide concentrates into technical grade molybdenum oxide (tech oxide), which is sold in powder form or briquettes or converted into pure molybdenum oxide or ferromolybdenum. Two other furnaces process spent catalyst material containing other metals.

A large portion of the molybdenum concentrates processed at the Langeloth facility come from the Thompson Creek Mine. TC also buys concentrates from other mining companies to process at Langeloth and sell in the market, and it also roasts concentrates on a toll basis for third-party customers.

Due to the difficulties of obtaining licenses for new roasters, the Langeloth complex has a value greater than its mere role in the TC's production stream. To some extent it is almost irreplaceable in Canada or the US. It struck us when we first heard of this asset that it was extremely costly to truck ore all the way from BC and Idaho to Pennsylvania. The unique status of Langeloth as a Moly roaster with the appropriate operating approvals

**Mt Milligan**

The Mt Milligan copper/gold asset is located 155 km NW of Prince George in British Columbia. The background to this asset is that it came on board from the acquisition of Terrane Metals in October 2010 for about $700mn. As part of the financing of the purchase of Terrane Metals a side deal was made with Denver based miner Royal Gold involving the sale of 25% of the gold produced by Mount Milligan during its entire mine life; that transaction helped Thompson Creek finance the Terrane deal by providing it with $226.5 million in cash and another $85 million during the mine's construction.

The Mt. Milligan project is based on a conventional truck-shovel open pit mine and 60,000 tonnes per day copper flotation concentrator. The current capital expenditure estimate is $1.5 billion. Thus far Thompson Creek has incurred C$1.14 billion in cash spend since the inception of the project through December 31, 2012.

The mine is being built over a 30-month period, with expected completion in the third quarter of 2013 and commercial production expected to commence in the fourth quarter of 2013. Average annual production over a 22-year mine life is forecast to be 81 million pounds copper and 194,500 ounces gold. The mine plan has been designed for extraction of higher grade and rich reserves in the early years. In the first six years of the mine plan, copper production is expected to average 89 million pounds per year and gold production is expected to average approximately 262,100 ounces per year. Highlights of the Feasibility Update Study are:

- Gold in reserve 6.0 million oz (second largest gold reserve in Canada)
- Copper in reserve 2.1 billion lbs
- Mine life 22 years (was originally 15 years)
- Life-of-Mine strip ratio steady at 0.84/1

During the fourth quarter and year ended December 31, 2012, Thompson Creek made cash capital expenditures (including capital leases) of CAD$186.3mn and CAD$678.5mn, respectively, for the project. These expenditures were primarily related to the ongoing construction of the tailings storage facility, buildings and facilities (concentrator, truck shop, administration building, and primary and pebble crushers), plant site earthworks, cement works, steel erection, construction camp costs, mine development, mining equipment and engineering design costs.

| Balance Sheet Comps | TC | HBM |
|---|---|---|
| as at 31 March 2013 | | |
| | USD (mns) | CAD (mns) |
| Cash & Equivalents | 469.3 | 1,050.48 |
| Short Term Investments | - | 0.23 |
| Cash and Short Term Investments | 469.3 | 1,050.70 |
| Accounts Receivable - Trade, Net | 65 | 86.44 |
| Total Receivables, Net | 76.3 | 141.98 |
| Total Inventory | 156.1 | 59.61 |
| Prepaid Expenses | 13.5 | 60.61 |
| Other Current Assets, Total | 25 | - |
| **Total Current Assets** | **740.2** | **1,312.89** |
| Property/Plant/Equipment, Total | 2,817.80 | - |
| Accumulated Depreciation, Total | -195.2 | - |
| Goodwill, Net | - | 68.18 |
| Intangibles, Net | - | 13.35 |
| Long Term Investments | - | 97.02 |
| Other Long Term Assets, Total | 65.2 | 21.04 |
| **Total Assets** | **3,428.00** | **3,508.75** |
| | | |
| Accounts Payable | - | 236.17 |
| Current Port. of LT Debt/Capital Leases | 35 | - |
| Other Current Liabilities, Total | 21.5 | 134.87 |
| **Total Current Liabilities** | **162.3** | **371.04** |
| Long Term Debt | 918.1 | 488.43 |
| Capital Lease Obligations | 74.5 | - |
| Total Long Term Debt | 992.6 | 488.43 |
| Total Debt | 1,027.60 | 488.43 |
| Deferred Income Tax | 122.1 | 222.27 |
| Minority Interest | - | -0.31 |
| Other Liabilities, Total | 772.5 | 767.99 |
| **Total Liabilities** | **2,049.50** | **1,849.42** |
| Common Stock, Total | 1,025.80 | 1,020.90 |
| Additional Paid-In Capital | 227.7 | - |
| Retained Earnings | 93.2 | 638.43 |
| Other Equity, Total | 31.8 | - |
| **Total Equity** | **1,378.50** | **1,659.33** |
| **Total Liabilities & Shareholders' Equity** | **3,428.00** | **3,508.75** |

Upcoming milestones include the completion of the concentrator building (installation of all mill equipment, piping and electrical); the 400-meter conveyor line from the primary crusher to the mill; the truck maintenance shop; and the administrative building.

According to TC the mine-build remains on schedule and it is currently estimating an aggregate of approximately CAD$1.5 billion to construct and develop the mine of which approximately CAD$390 million of expenditures remain to be spent, plus an additional CAD$40 million to CAD$50 million of estimated future cash capital expenditures for a permanent operations residence at Mt. Milligan, which is expected to be completed in 2014.

**Other Projects of Note**

Thompson Creek also has two other projects that appear prospective on its books. Most promising is the Berg Lake property in North Central British Columbia. This has a Measured and Indicated resource of 3.342bn lbs of copper and 412mn lbs of Moly.

The company currently has the Davidson property on hold. This deposit was first discovered in 1944, and represents the largest undeveloped molybdenum deposit in Canada. Located on the east side of Hudson Bay Mountain and approximately nine kilometres from Smithers, the deposit lies 300 to 450 metres below ground and is currently accessed by a two-kilometre tunnel developed in the 1960s.

**Financials**

We won't go into any projections here but comparisons are useful. Clearly the earnings picture is very much less attractive at TC than at HBM but surprisingly, despite the large market cap difference the balance sheet footings (shown on the previous page) are rather similar with HBM having the advantage mainly in its cash-pile.

Surprisingly also there is not a substantial difference in the debt levels to justify the much lower valuation the market puts on TC.

What TC lacks in cash (and $470mn is not to be sneezed at) it makes up for in inventory and not having the sizeable unwritten off goodwill/intangibles that HBM holds and the Long Term Investments, the details of which probably don't bear much close examination.

Clearly then the key is the earnings difference, but as we have noted earlier that is probably transitory as Mt Milligan kicking in will change the dynamic at TC for the better.

The earnings in recent times are shown on the tables on the following page. Interestingly while TC undeniably had a bad year both pre- and post-writeoffs, it has bounced back handsomely in the first quarter of the current year. In fact a case could be made that while Moly is TC's Achilles heel, Lead/Zinc have a similar effect weighing upon HBM, so HBM cannot afford to be too snotty in any approach to TC. Indeed TC could make a good case for a near merger of equals.

| **HudBay** | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **In Millions of CAD** | **1Q13** | **FY12** | **4Q12** | **3Q12** | **2Q12** | **1Q12** | **FY11** | **FY10** | **FY09** |
| Total Revenue | 119.88 | 702.55 | 181 | 144.66 | 189.86 | 187.04 | 890.82 | 781.03 | 720.72 |
| Cost of Revenue, Total | 95.19 | 504.96 | 139.52 | 96.69 | 137.46 | 138.9 | 587.38 | 548 | 506.27 |
| Gross Profit | 24.69 | 197.59 | 41.47 | 47.97 | 52.4 | 48.14 | 303.44 | 233.03 | 214.45 |
| Selling/General/Admin. Expenses | 10.86 | 38.71 | 11.41 | 9.64 | 7.7 | 9.96 | 38.74 | 28.19 | 48.87 |
| Research & Development | 8.72 | 43.57 | 10.95 | 9.18 | 10.68 | 12.76 | 46.92 | 81.73 | 7.61 |
| Depreciation/Amortisation | 0.21 | 0.8 | 0.2 | 0.21 | 0.2 | 0.2 | - | - | 100.73 |
| Unusual Expense (Income) | 1.74 | 40.06 | 6.5 | 0 | 31 | 2.56 | -2.45 | -0.01 | 0 |
| Other Operating Expenses, Total | 2.01 | 9.14 | 1.67 | 3.55 | 2.8 | 1.12 | 8.38 | 12.99 | 4.49 |
| Total Operating Expense | 118.73 | 637.24 | 170.26 | 119.26 | 189.83 | 165.5 | 678.97 | 670.9 | 685.72 |
| Operating Income | 1.15 | 65.31 | 10.73 | 25.4 | 0.03 | 21.54 | 211.85 | 110.13 | 35 |
| Other, Net | -2.36 | -19.75 | -3.53 | -5.29 | -6.72 | -4.21 | -6.61 | -4.38 | 2.58 |
| Income Before Tax | 7.92 | 52.15 | 23.34 | 4.96 | -31.72 | 16.97 | 209.03 | 108.67 | 141.47 |
| Tax | 6.01 | 73.32 | 15.9 | 11.1 | 29.72 | 13.62 | 133.83 | 68.26 | 28.99 |
| Income After Tax | 1.91 | -21.17 | 7.44 | -6.14 | -61.44 | 3.35 | 75.2 | 40.41 | 112.48 |
| Minority Interest | 0.1 | 2.66 | 0.19 | 0.48 | 0.84 | 1.15 | 6.18 | 2.72 | -0.04 |
| Net Income | 2 | -18.51 | 7.63 | -5.66 | -60.6 | 4.51 | -153.9 | 23.97 | 112.44 |
| Diluted Weighted Average Shares | 172.32 | 171.96 | 172.01 | 171.97 | 171.96 | 172.31 | 167.86 | 151.34 | 154.07 |
| Diluted EPS | 0.01 | -0.11 | 0.04 | -0.03 | -0.35 | 0.03 | 0.48 | 0.29 | 0.73 |

| Thompson Creek | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **In Millions of USD** | **1Q13** | **FY12** | **4Q12** | **3Q12** | **2Q12** | **1Q12** | **FY11** | **FY10** | **FY09** |
| Total Revenue | 108.7 | 401.4 | 99.4 | 74.9 | 113.5 | 113.6 | 669.1 | 594.8 | 373.4 |
| Cost of Revenue, Total | 81.4 | 444 | 99.8 | 102.9 | 122.1 | 119.2 | 467.5 | 365.4 | 284.7 |
| Gross Profit | 27.3 | -42.6 | -0.4 | -28 | -8.6 | -5.6 | 201.6 | 229.4 | 88.7 |
| Selling/General/Admin. Expenses | 9.4 | 37.9 | 9.7 | 8.9 | 9.2 | 10.1 | 38.1 | 32.7 | 32.7 |
| Research & Development | 0.1 | 2.2 | 0.3 | 0.5 | 0.6 | 0.8 | 14.2 | 9.4 | 6.3 |
| Depreciation/Amortisation | - | - | - | - | - | - | - | - | - |
| Unusual Expense (Income) | - | 577.5 | 530.5 | 47 | - | - | 0 | 12.9 | 0 |
| Other Operating Expenses, Total | 0.8 | - | - | - | - | - | - | - | - |
| Total Operating Expense | 91.7 | 1,061.60 | 640.3 | 159.3 | 131.9 | 130.1 | 519.8 | 420.4 | 323.7 |
| Operating Income | 17 | -660.2 | -540.9 | -84.4 | -18.4 | -16.5 | 149.3 | 174.4 | 49.7 |
| Other, Net | -0.1 | 0.5 | 0.2 | -0.1 | 0.1 | 0.3 | 1 | 1.1 | 0.3 |
| Income Before Tax | -2.3 | -657.4 | -556.6 | -64.2 | -25.6 | -11 | 303.3 | 133.9 | -54 |
| Tax | -3.2 | -111.1 | -72.2 | -16 | -10.8 | -12.1 | 11.2 | 20.2 | 2 |
| Income After Tax | 0.9 | -546.3 | -484.4 | -48.2 | -14.8 | 1.1 | 292.1 | 113.7 | -56 |
| Minority Interest | - | - | - | - | - | - | - | - | - |
| Net Income | 0.9 | -546.3 | -484.4 | -48.2 | -14.8 | 1.1 | 292.1 | 113.7 | -56 |
| Diluted Weighted Average Shares | 216.3 | 168.4 | 168.6 | 168.7 | 168.2 | 168.5 | 168.6 | 152.5 | 127.5 |
| Diluted EPS | -2.87 | -3.24 | -2.87 | -0.29 | -0.09 | 0.01 | 1.73 | 0.75 | -0.44 |

**Risks**

The main risks for such a transaction are:

- Hudbay over-paying (First Quantum have shown unsolicited bids can win the day in the current environment)
- Moly continuing to be flaccid for many years to come
- Capex overruns at Constancia become a burden for the merged group

Our constant fear with Canadian predators is that they don’t have a nasty bone in their body when it comes to M&A negotiations. They seem to feel that sitting managements have the whiphand and thus when the target asks for 100% premiums then it must be worth it, or :”that is the price you have to pay”. Time and time again this lack of sharp elbows in the negotiating tussle has meant that shareholders of the predator end up severely disadvantaged and moreover left holding the baby (look at Kinross with Red Back and Underworld). Thus we feel that HudBay paid too much for Norsemont and probably now realize it and hopefully feel that they will be able to make a good case that 1+1 = 3 in the case of this merger with TC rather than be suckered into paying too much. First Quantum’s amiable but ultimately unwanted offer for Inmet won the day and the market has rewarded the company with a 30% uplift since the deal closed. This should be a lesson to all that if the target is damaged enough reputation-se or beaten down enough pricewise then an offer out of the blue need not be doomed to fail.

Moly’s price is not great but neither is it disastrous. In any case it is shortly going to have a much healthier product mix with sizeable copper and gold coming out of Mt Milligan. TC is a bargain at this time but will not stay that way no matter what happens to Moly.

Before HudBay gets too snooty about TC, we should point to whatever the damage wrought by Mt Milligan that is now behind TC, whereas the many surprises of mine-building in LatAm (look at Vale and

Brrick's recent experiences) still await HudBay at Constancia. That is an imponderable as long as companies rely upon unreliable and irresponsible consultants to design and budget mine-builds.

**Conclusion**

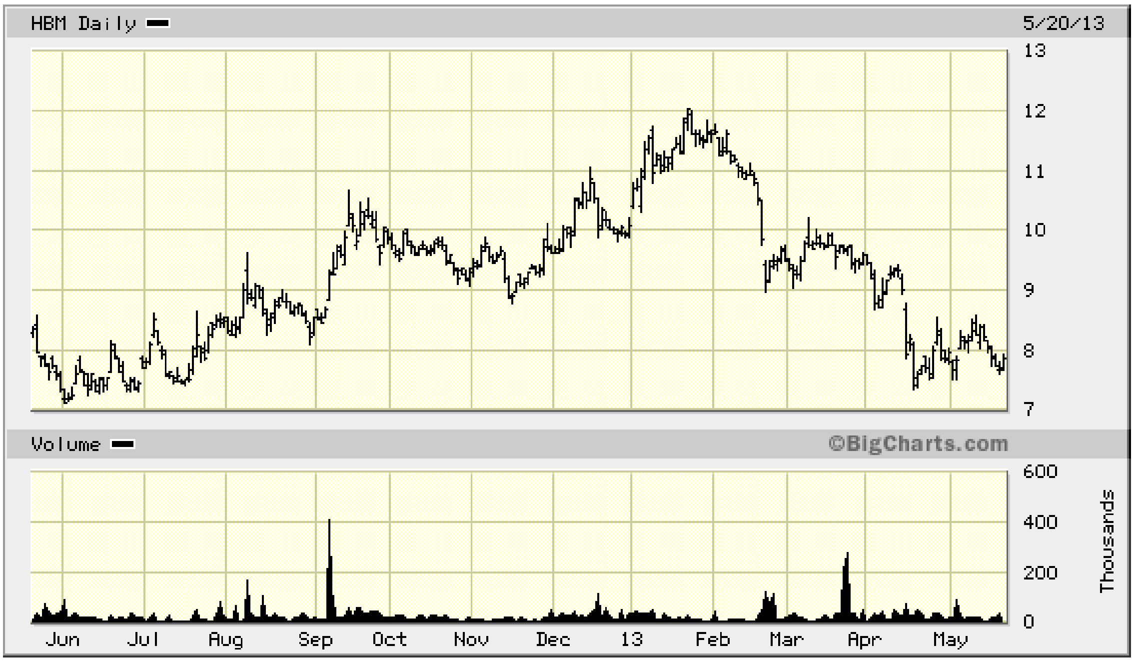
As we have been proselytizing with increasing vigour in recent times that the Canadian market needs a sea change, the most obvious change that would help would be the "restocking" of the upper ranks of the mining food chain. So many diversified major mining companies were lost in the Canadian mining space that the pyramid became very flattened. While juniors touted their saleability to majors the number of majors was winnowed out while the number of juniors proliferated. This stuck a stick in the spokes of the bicycle.

With all mining companies on the prowl for "deals at a premium" the old concept of mergers of equals went by the wayside. Someone had to be taking someone else out for a massive premium leaving the departing management to bathe in the glory of their deal-doing and the surviving management to explain away for years why they "paid too much". The transaction we have mused upon in this note is note a merger of equals but a merger of former equals. Once upon a time Thompson Creek rode high and its big-thinking has been its downfall. HudBay's glory days though were many decades ago when it was a pillar of the mining establishment. Nowadays it is an under-promoted stodgy quasi-cashbox.

In our view putting TC together with HudBay would take both out of the mid-tier and create a new Canadian based major capable of accreting mining assets and bringing them to fruition. A spin-off from more majors being in existence might be the revival of a true large-cap institutional investment community in Canada rather than just a coterie of punters. Putting together these two companies would be not only an equation of one plus one equals three but move the combined entity up the totem pole both in Canadian and global rankings. It would create a major new Western Hemisphere mining major.

Economically though it also more attractive to acquire TC while it is in its current vulnerable state. Once the revenue income from Mount Milligan turns the tide on net cashflow then the opportunity will be lost. That is one of the reasons why we have persisted with this name in the Model Mining Portfolio despite its travails. TC would plug the revenue gap at Hudbay where funds look likely to continue flowing out until 2015 to support the Constancia build-out. If a HudBay/Thompson Creek combine was achieved the entity would be an earnings monster with a significant option on the future of the Moly price. If that metal can struggle up from the current $11 per lb to around $15 (not an outrageous expectation) then there would be a big kicker for revenues. Only zinc in the HudBay portfolio holds such bullish expectations in our minds.

Therefore our contention is that a deal between these two companies would make eminent sense for all concerned. We reiterate our **Long** position on Thompson Creek in the Model Mining Portfolio with a 12-month target price of $6.


HBM Daily
5/20/13
13
12
11
10
9
8
7
Volume
©BigCharts.com
600
400
200
0
Thousands
Jun
Jul
Aug
Sep
Oct
Nov
Dec
13
Feb
Mar
Apr
May

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