Mercenary Musings on the Markets

A Monday Morning Musing from Mickey the Mercenary Geologist

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It has been a busy two weeks in Vancouver, B.C. The Cambridge House conference on June 15-16 was well-attended with more than 250 exhibiting companies. This was the last of the major shows until September as most companies with North American-based projects are well into their field seasons and the markets are easing into the yearly summer doldrums.

My time in Vancouver has been spent evaluating companies for investment, meeting with principals of the stocks I hold, exploring private placement opportunities, helping evaluate a merger deal, managing my portfolio, and of course, socializing with friends and fishing on the weekends.

I also took a trip to Yellowknife, NWT, to view Avalon Ventures' Thor Lake project. Led by geologist Don Bubar, this is an exciting rare metals play with a potentially world-class rare earth element deposit. I will report more about this interesting company in a later Musing.

The junior resource sector is stumbling and bumbling. There are numerous companies whose prospects look increasingly dim. Most junior exploration companies have been around for a few years; many since the early days of the boom in mid-2003 to early 2004. The average life span of the average junior is probably 5-7 years. Not only are the companies run by gray-hairs, their flagship projects are mature with major decision points being reached. By the nature of discovery, most of these projects will eventually fail.

Share structure is becoming a major concern for companies and investors. Repeated equity financings have resulted in substantial dilution (i.e., too many shares outstanding) and in many instances, insiders have lost control of their company's market. Many have done financings at lower unit prices over the past year and a half. They are trading at or near 52 week lows and for some, working capital is dangerously low. Now they must go back to the market for another infusion of exploration and administrative dollars at a time when market capitalization is down thru out the industry. Because of the skittish markets and economic concerns, investors are risk averse and many proposed financings are going begging.

Many junior companies are slowly dying. They are desperate for a miracle cure, a wonder drug, a fountain of youth. Mergers, acquisitions, joint ventures, and so-called strategic combinations are the initial attempts at self-preservation. However, merging companies with little value creates only bigger

companies with lesser value. Most of these strategies will not succeed; they'll just prolong the inevitable. There will be massive carnage, rape, and pillage in the next 12-24 months and many juniors will not survive. The business is downsizing and it won't be pretty.

Many deals were financed in the giddy days from late 2003 to mid 2007 that did not deserve funding. The projects were simply unworthy of venture capital. Now they are old soldiers, mortally wounded, and will die on the battlefield. The companies, deeply in debt, will fail, become shells, roll back, undergo RTO's, change their business, and reincarnate as new investment vehicles in another sector in another time in another bubble. Such is the nature of the venture capital business.

It's not a bear market but it is bearish. Although Toronto Venture Exchange daily volumes for May were up 4% from a year ago, the market value of those trades was off 25%. Meanwhile, average market capitalization is down a more modest 16%. Looking at cumulative statistics from January to May 2008 compared with the same period in 2007 does not paint a pretty picture: Volume is down 13%, traded value is off 37%, and perhaps more importantly, equity financings are off a whopping 48%.

In addition, market statistics for April and May are positively skewed by recent successes in some resource sectors. The flavors of the month are potash, coal, and shale gas.

World food demand is skyrocketing as the masses in China and India now have the financial wherewithal to buy a better diet. Daily caloric intake is catching up with the West and fewer children in the world are going to bed hungry. As a result, fertilizer demand is soaring, prices have skyrocketed, and potash companies are booming.

A junior gets lucky, finds a coal deposit while drilling for diamonds, and a new coal boom is born in a prairie province.

$140 oil and $13 natural gas drive speculative dollars into exploration and development, make horizontal drilling and fracturing technology viable, and tight gas potentially economic. There is a run on any shale gas play in North America no matter where it is located or how far it is from the nearest pipeline.

In my opinion, these stock plays are presently overvalued. They are reminiscent of the irrational market for uranium stocks when the spot price peaked 12-15 months ago. A press release with as little as a high grade uranium rock sample from any part of the world or a moose pasture land grab in the Canadian North would generate a substantial market cap increase. In my view the correction is coming for potash, prairie coal, and shale gas area plays. Only the real companies with real deposits in these commodities will continue to have real value. However, the correction will hit all in these sectors.

So how do we find value in such a difficult market? Note that I previously said a "bearish" not "bear" market. The difference between the two is substantial. *Success is still being rewarded and good deals are still being financed.* In a junior bear market, nothing works, nothing gets funded, and any news becomes just another selling opportunity. Do you remember the dark days of 2000 and 2001 for the natural resource sector? That was a *bear* market.

Presently I am looking for undervalued gold companies and conventional gas deals that are in production, nearing production, or have good prospects for increasing production. I also surmise that the uranium bottom has been reached or is near so uranium companies with pounds-in-the ground, near term production, or new discoveries are attractive. All these companies must have plenty of cash in the bank.

My latest investments include Pelangio Gold (PLG.T), Redcliffe Exploration (RXP.A), and Hathor Exploration (HAT.V). Pelangio has performed particularly well since I bought it, up nearly 40% and with

a spin-off set to close in about another month. Redcliffe has announced a major summer drill program in Alberta and is over 15%.

Hathor has started drilling land-based targets northeast of their exciting Roughrider uranium discovery in the Athabasca Basin. Fission Energy (FIS.V), another of my uranium holdings, is well into its summer drill program adjacent to Hathor's discovery. These are risky plays that are totally dependent in the near term on positive drill results. Drilling on the ice this winter will indicate whether Roughrider will become a significant uranium deposit. I am currently accumulating Hathor on weakness.

I recently sold a gold exploration company that never got off the ground in15 months. I did not want to upset the market in a thinly traded issuer and called the CEO who was able to arrange a cross at my break even price. It was a win-win for both parties: I placed my stock and got my capital out; the company got a little liquidity and an increase in trading price. I sincerely thank him for the help. As always, I encourage you to call and talk with company insiders.

My current strategy is to continue the search for value in the gold and energy sectors. Key components are production or advanced properties nearing production, strong working capital positions, and well-managed share structure. In the coming weeks, I intend to liquidate some of my lesser performers in gold and base metal exploration and trade a substantial amount of paper for cash. As always, a portion of that cash will be moved into physical precious metals.

These are trying times for venture capital investors. In my opinion, this is the time develop a plan and be disciplined by buying production and moving paper into cash. For those inclined to accept speculative risk as I do, buying production will help mitigate that risk. For others, it may be a time to sit on the sidelines in cash until the markets improve. I do not see any upturn in the junior markets until the next run-up in the price of gold. I think that is likely to occur in the fall. In my current thinking, I do not expect the junior resource market to improve substantially until the first quarter of 2009 and then only for the strongest companies.

Ciao for now,

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The **Mercenary Geologist Michael S. "Mickey" Fulp** is a Certified Professional Geologist with a B.Sc. Earth Sciences with honor from the University of Tulsa, and M.Sc. Geology from the University of New Mexico. Mickey has 30 years experience as an exploration geologist searching for economic deposits of base and precious metals, industrial minerals, uranium, coal, oil and gas, and water in North and South America, Europe, and Asia.

Mickey has worked for junior explorers, major mining companies, private companies, and investors as a consulting economic geologist for the past 22 years, specializing in geological mapping, property evaluation, and business development. In addition to Mickey's professional credentials and experience,

he is high-altitude proficient, and is bilingual in English and Spanish. From 2003 to 2006, he made four outcrop ore discoveries in Peru, Nevada, Chile, and British Columbia.

Mickey is well-known throughout the mining and exploration community due to his ongoing work as an analyst, newsletter writer, and speaker.

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