Casey's International Speculator

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New Company Recommendation: Columbus Gold

We sent Louis James on a due-diligence tour to French Guiana, to see XL honoree John Prochnau's new gold play there. We liked what he saw there enough to issue an investment alert on the stock, which has since had time to settle back. If you are disciplined enough, you may be able to get in at the same price as alert subscribers, or even lower, if the market corrects even more strongly.

Columbus Gold Corp. HM: Au V.CGT, CBGDF.OB, www.columbusgoldcorp.com			
Price	Share: C$0.87	MCap: C$34.4M	On 2/1/11
Shares	SO: 39.5M	FD: 49.7M	As of: 1/17/11
Warrants	UnEx: 5.5M	C$0.30	Exp: 11/21/11
Options	Open: 4.6M	C$0.25-C$1.68	Exp: 5/24/11-12/6/15
Cash	Est. C$2M +C$2M PP	Burn: $600K/mo	As of: 1/11

BUY UNDER C$0.80—We are buying back into Columbus, based on the compelling case for unrecognized value in its new Paul Isnard project in French Guiana. However, the company is still advancing the Nevada exploration projects we liked before. This gives us lots of ways to win, something we always prefer in a speculation. By the Ps…

People

Columbus is led by Robert Giustra, a former investment banker who's been working in the resource sector since 1992. Robert's greatest strength may be in team-building – finding the right people to work on given tasks – but he's also shown he can raise money with minimal dilution.

Getting Columbus off the ground, Robert teamed up with Andy Wallace and John Livermore, legendary Nevada gold prospectors (Livermore is the geo credited with the original Carlin discovery in Nevada, among others, and Wallace also has numerous economic gold discoveries under his belt). These two rock stars founded an exploration company called Cordex, which has an exclusive exploration contract with Columbus.

Explorers' League honoree John Prochnau was a founding director of CGT. He's since retired from the board – and management of any companies – but is still actively involved in Columbus, especially with the new Paul Isnard project. He's the one who did the original due diligence on the project and flew with me to French Guiana on my recent trip there. It was clear on the trip that while Robert leads the company, John is leading the project, and it couldn't be in better hands.

On the ground in French Guiana, the Columbus team is working with the team long established in the country by Auplata, the French company from which CGT bought the Paul Isnard project. These people have been working for years in a place others have dared not go, and they have found, permitted and put into operation two open pit mines with gravity mills. These properties are near, but not part of the Paul Isnard deal.

Combine this hands-on experience with Midas Prochnau's geological insight and Robert's ability to raise money and close deals, and you have a great combination that covers all the bases.

What about last time? Columbus was not a winner for us when we recommended it in 2006, it's true – but that was not due to failure on management's part; they did the work they promised. Mother Nature simply didn't cooperate. It happens to the best of them.

Longtime readers may recall that Robert and John also worked together on Empire Mining (V.EPC), a company we first picked up as a Canadian capital pool company that went into chromite in Albania and languished for a long time. We finally got a chance to exit with our initial investment recovered, so we took it. As it happens, EPC made an important new copper discovery in Turkey, while I was in Paris with Robert and John, and the shares are way up. If we'd held on longer, we'd have made… but that's futile thinking. The point is not to cry over spilled milk, but to point out that these People have delivered in the past.

This time that's less of an issue, because there's no discovery risk in this play; it's all about doing good work to add value, going forward. We are confident this team will deliver.

Property

Columbus has two properties in Utah and 20 in Nevada, where Andy Wallace and the Cordex team are still very active. Eleven of these will be drilled this year, with about 31,000 meters of drilling planned. These are all exploration plays with merit, and several could add significant value this year, but the focus now is on Paul Isnard, the new acquisition in French Guiana.

We say "acquisition" here only for lack of a better term. Columbus is buying an initial 51% interest, which it can take to 100% by spending C$7 million and producing a bankable feasibility study within four years. However, Auplata, the vendor, is acquiring 49% of Columbus, partly through a C$2 million private placement into CGT. This deal is really more like a partial merger that avoids the substantial regulatory complications of formally merging a French and a Canadian company.

What do we get for giving up half the company to these new partners? We go from having nothing in the bag to having 1.9 million 43-101-compliant Inferred ounces of gold, at an average grade of 1.6 g/t – to start with. That's a good grade for an open pit project that appears to be amenable to conventional processing (the mineralization is not refractory). Better yet, that's at a 0.4 g/t cut-off grade, using $1,200/oz gold, and if you up the cut-off grade to 0.9 g/t, you still have 1.6 million ounces grading 2.2 g/t – very robust-looking numbers.

There are also historical resource estimates, including a 43-101-compliant one in 2004 by RSG Global that tallied 2.93 million Inferred ounces averaging 1.5 g/t gold. Only half a million of these fell in the $375/oz open pit projected then, so we take those numbers with a grain of salt, but they do suggest that it will be easy for this deposit to get much larger.

Louis went over John's proposed drill plan with him and Auplata's geologists while on site. He saw many areas within the three-kilometer-long resource zone that would currently be modeled as waste, but have not been drilled and shown to be barren. Each one of these that returns positive drill results in the upcoming drill campaign will reduce internal waste and add gold. The deposit is also wide open to depth, with no drilling below some of the highest-grade zones discovered thus far.

Given the consistency of the past drill results and the number of blank areas that simply have not been tested, we believe it should be relatively easy to drill off three million ounces of gold. Four million would not be much of a stretch, even without discovering any new areas of mineralization. And new discoveries are entirely possible, with many targets crying out for testing.

John Prochnau, normally a very calm and understated engineer who tells you the bad along with the good without much emotion, is *very* excited about Paul Isnard. We trust John, and it's clear that to him it's not a question of whether or not the deposit will get bigger, but of how much bigger it will get.

Chief among the negatives John was candid about is that the deposit dips back under a hill. That will impact the strip ratio, a very important cost factor. However, some of the best grades are found towards the bottom of the current resource, and higher-grade discoveries at depth would certainly help pay for pushing the hill back. Plus the deposit is open to expansion internally, as well as laterally along strike, particularly to the west.

Montagne d'Or, "Gold Mountain," location of the 1.9 million ounces of gold the Paul Isnard project already has. Note the destruction of the jungle in the foreground, caused by illegal miners, chased off by the departmental government.

There is also a gross sales royalty payable to Euro Resources SA on the first 5Moz gold production from the project (10% less $400/oz Au on the first 2Moz, then 5% less $400/oz Au on the balance). There is another royalty payable to the Department of French Guiana, for distribution to the local communes (towns), of €224.18/kg gold production for small and medium-sized companies and €448.36/kg for larger companies. This second royalty, to the government, is not too bad as these things go, but the first is more onerous. Management has plans to get it reduced.

The good thing about these liabilities – and every project has some liabilities – is that they will come into play during the feasibility stage of the project's development. That's a fight for another day. The basis of the spec now is that Paul Isnard is probably already larger than reported at present, and unless Mother Nature is exceptionally uncooperative, the company has the means to make it much larger in short order.

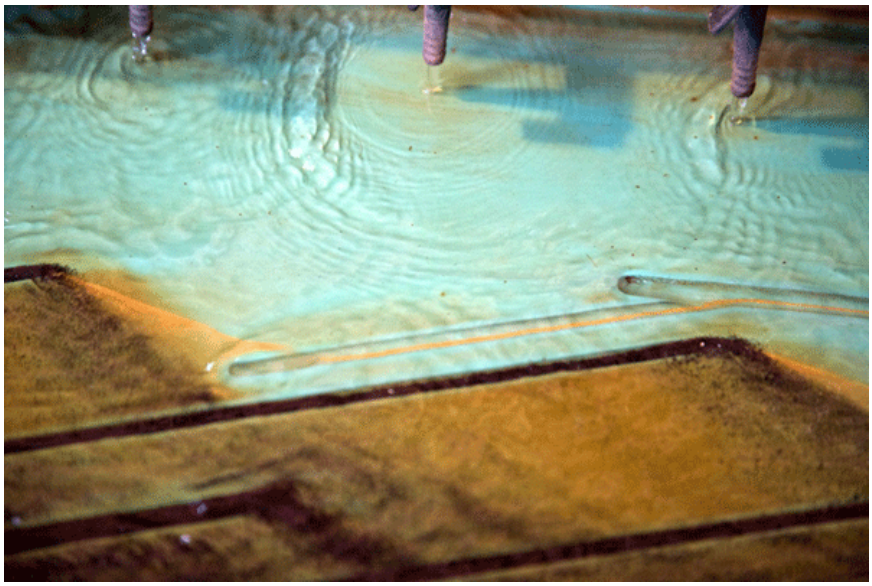
The big risk here is political.

Politics

French Guiana has a negative reputation in the mining industry because the current French government under Sarkozy shot down IAMGOLD's Camp Caiman project in 2008. As I understand it, IAMGOLD did everything right, including environmental studies, and when it came to the end of the permitting process, the government simply refused.

Note here that French Guiana is not a former French colony, but a current department of France. The regulators are in Paris, which is where I met with them. Those regulators and the French officials I met with in the department of French Guiana itself gave every indication of being very keen to see responsible mining advance. This is important because the French government has a certain amount of time to object to the Columbus-Auplata deal. That time expires next month, unless extended. Thus far, indications are that the government will not object.

It's worth noting that Auplata is open pit mining in two locations in French Guiana now – clear evidence that the government is not hostile to all mining. Permitting may be an issue in the future, but for now, the government seems inclined to cooperate.



A stream of gold particles flowing down the grooves of a vibrating table in the final stages of one of Auplata's gravity separation circuits in French Guiana. Auplata is one of the biggest private-sector employers in the department.

The unofficial picture I have assembled is that when the government chased out all the evil multinational mining companies, they forgot that nature abhors a vacuum. As soon as the countryside was quiet and deserted, hordes of illegal miners from Brazil swarmed over the border, using footpaths that honeycomb the jungle, and started tearing up the countryside.

I've seen the damage these "artisan" miners can do, in many locations throughout South America. They often use toxic mercury to process gold ore, and they have no qualms about dumping their tailings into local rivers. They throw trash all over the place and make no effort to restore the land to its original condition when done. They use explosives and sometimes even mechanized mining equipment, with little regard to safety, resulting in frequent deaths from cave-ins in their workings. Somehow, this is better to many environmental extremists than the evil multinational companies operating according to international environmental standards, but that's another story.

The government has tried to chase these locusts away, but when they make a show of force, the illegals just melt into the jungle and show up at another spot. In fact, while meeting with the prefect of French Guiana (sort of like a state governor in the U.S., but with more far-reaching powers), he asked the Auplata guys if they could step up their work so the illegals would not come back to areas the police had just cleared, where Auplata has mineral rights. Auplata responded that they had permits pending, and that with those granted, they could get to work. The prefect immediately picked up his phone and asked his underlings where those permits were. A very good sign, I'd say.

What about Camp Caiman? Well, there were apparently caimans sunning themselves along the river there (hence the name), and that was the environmental concern that did the project in. I heard there was a new plan afoot that would move the processing (which would involve cyanide) some kilometers away from the mine and the river, pretty much eliminating the risk of accidental harm to any caimans. Be that as it may, the problem was pretty specific to Camp Caiman, and I saw no caimans, nor animals of any sort beyond insects, on Paul Isnard. Well, there was a camp dog, with puppies.

I was convinced that the local officials do indeed want responsible mining (which is also tax-paying mining, in contrast with the illegal operations) to boost their economy. The department is not self-sufficient and is heavily dependent on France, which is cutting its budget – this is being felt, locally. I was less certain about the regulators in Paris, but they too know about the problem with the illegal miners.

The bottom line here for now, however, is that permitting is a problem for another day. Sure, the market may give Columbus a discount because of the Camp Caiman fiasco – but it is already doing so. If CGT's discounted gold resources double in size, the still-discounted but much larger resource is going to move the stock price.

Paper & Phinancing

With Auplata buying into Columbus, the situation here is a little murky and won't settle for a while. The main thing to understand is that CGT has a reasonable share structure now, and that new paper created to accommodate its partner is not going to hit the market anytime soon.

Also, in addition to the cash CGT has on hand, there's another +$2 million coming in from deeply-in-the-money warrants, and the $2 million more coming from Auplata's private placement in CGT (part of the current deal). Further, management reports that key institutional shareholders have already said they will provide additional financing. What this means is that CGT has enough cash to start drilling as soon as logistics can be arranged, and enough cash coming in to complete its earn-in to 100% of Paul Isnard. Full feasibility work will take more money, but that will be some time down the road, and we'll see drill results and a new resource estimate before then, likely leading to a higher share price.

In short, the company has the cash it needs for the work already planned to add value. It probably will finance, but only when it can do so at a higher share price, which would imply that we're already ahead of the game.

Promotion

Columbus shares have more than doubled since the news of the Paul Isnard deal, so the story doesn't seem to need much help getting out there. However, Robert knows that John Prochnau is an engineer, not a salesman, and has told me he's taking steps to get the right people in place to get the story told. I know the company has a booth at the investment shows, and now that they have a more advanced project to talk about, they are getting more attention. So far, so good.

Push

The next big milestone should be the lapse of the period the government has to object to the sale of Paul Isnard, due in two weeks. That could give the shares a significant boost, as investors who remember Camp Caiman may be thinking the government will object to the deal. We think it is unlikely the government will object, but they may ask for an extension of time to consider the deal. If they do, it could hit CGT's share price hard, without actually being bad news – we've met with the regulators and they were favorably disposed, so an extension of the objection period could just be a show of due diligence on their part. Unless they gave some reason to think they were working on an objection, we would see a sell-off on news of such a delay as a buying opportunity. Watch for it.

After that, and shareholder approval (and CGT shareholders would be nuts to object to the deal, as it just turned their stock into a winner), it will be largely up to John's drill program. Though Columbus plans to work with its Auplata partners on the project, it's going to take some time to assemble CGT's own technical team and mobilize equipment and field help. The rainy season is coming to French Guiana in a couple months, so it's not clear right now if the company will be able to drill before then, or if it might have to wait until mid-year. However, Robert made it clear that if at all possible, Columbus will get the truth machine turning on John's drill targets before then, to start showing the market what the project potential is.

Later in the year, there should be an updated resource estimate, and there's plenty of discovery potential along the way.

On a more speculative note, I think two companies this closely tied would naturally consider a full merger. Columbus shareholders would gain access to any upside in Auplata's other properties in French Guiana. Those are not profitable at present, with under 8,000 ounces of production in 2009, but they have substantial resources and a lot of exploration potential, since Auplata has focused on near-surface gold in saprolite (dirt), rather than sulfide ore in the fresh rock underneath. Auplata would gain access to North American markets, capital, and the substantial hard rock mining experience of Columbus' key people. Both sides are looking at about a 50/50 relationship now, so they don't really have much to lose.

Price

We like this new project. Having been on site with John and gotten a feel for the political risk myself, we think it's selling for a discount it does not fully deserve. That said, there's time to build a position and no need to chase the stock. The current 80-cent price range is a good entry point, but there's every reason to hope for lower prices in the weeks ahead, as gold continues to fluctuate, so we recommend shooting for less than 80 cents. If the French government asks for an extension to its objection period, you may be able to get in for 50 cents or less for a second tranche.

UPDATE March 4, 2011

Columbus Gold Corp. V.CGT, CBGDF.OB, http://www.columbusgoldcorp.com			
Price	Share: C$0.94	MCap: C$38.5 million	On: 3/2/11
History	Rec: C$0.87, 2/11	Gain: 8%	52-week: C$0.145-C$1.13
Shares	SO: 41 million	FD: 51.2 million	As of: 2/24/11
Warrants	UnEx: 4.5 million	C$0.30	Exp: 11/11-1/12
Options	Open: 5.7 million	C$0.25-C$1.68	Exp: 5/11-12/15
Cash	C$1.5 million	Burn: C$131K/mo	As of: 12/31/10

BEST BUY—Columbus' new flagship Paul Isnard project in French Guiana is perceived to be high-risk, politically, and right now, that looks like an opportunity to us.

First, remember that the project already has 1.9 million ounces of 43-101-compliant gold, and considerably more, according to one older 43-101 report – and yet the company is trading for less than, say, Bayfield (above), which has nothing in the 43-101 bag.

Now, what about the risk? As reported in our initial recommendation, the French government did shoot down IAMGOLD's Camp Caiman project, so there is good reason for the concern. However, if the government were concerned about what Columbus and its partner Auplata propose to do at Paul Isnard, they could have stopped it cold by objecting to the JV transaction by February 22 – and they didn't.

That's more than a good sign; it means that there should be no really major regulatory hurdles to deal with until it comes time to permit a mine. That's years away. For now, it's going to be all about what the truth machine turns up at Paul Isnard. And that, we agree with John Prochnau, looks very likely to add value. This is not your average drill play – it would actually be difficult for the geology to be so convoluted that all the gold there is to find here has already been found.

Will the market continue discounting these ounces? It might, but it doesn't matter. Even at a discount, as long as the number of ounces increases, Columbus' valuation should increase.

Plus, the company has work, paid for mostly with OPM, advancing on several of its Nevada projects. There's value here, and more probable upside than down. If we weren't long already, we'd buy a first tranche at current market, a second under 90 cents, and larger blocks under 65 cents, given the chance.