

The 2009 Aussie Gold Investment Kit

The recent massive expansion of the Federal Reserve's balance sheet and the huge bailout and spending plans by the U.S. Treasury and the Obama Administration now have many American investors worried about the imminent devaluation of the U.S. dollar and how to hedge against it.

The expansion of the Fed's balance sheet and the growth of the adjusted monetary base have both been breathtaking. As you can see from the charts on the next page, the Fed is lending hundreds of billions of dollars to the private sector in an attempt to unclog credit markets.

As this massive borrowing, lending, and spending campaign unfolds, you can expect the U.S. dollar to weaken against other currencies and against precious metals, especially gold. In the report that follows, you'll learn which Australian gold stocks we believe may benefit the most from the rising gold price.

We originally wrote about these stocks in *Diggers and Drillers* in December of 2008. You may have missed it. But with the recent events in the financial markets, it's become more important than ever to find real ways to hedge your risk to a falling dollar.

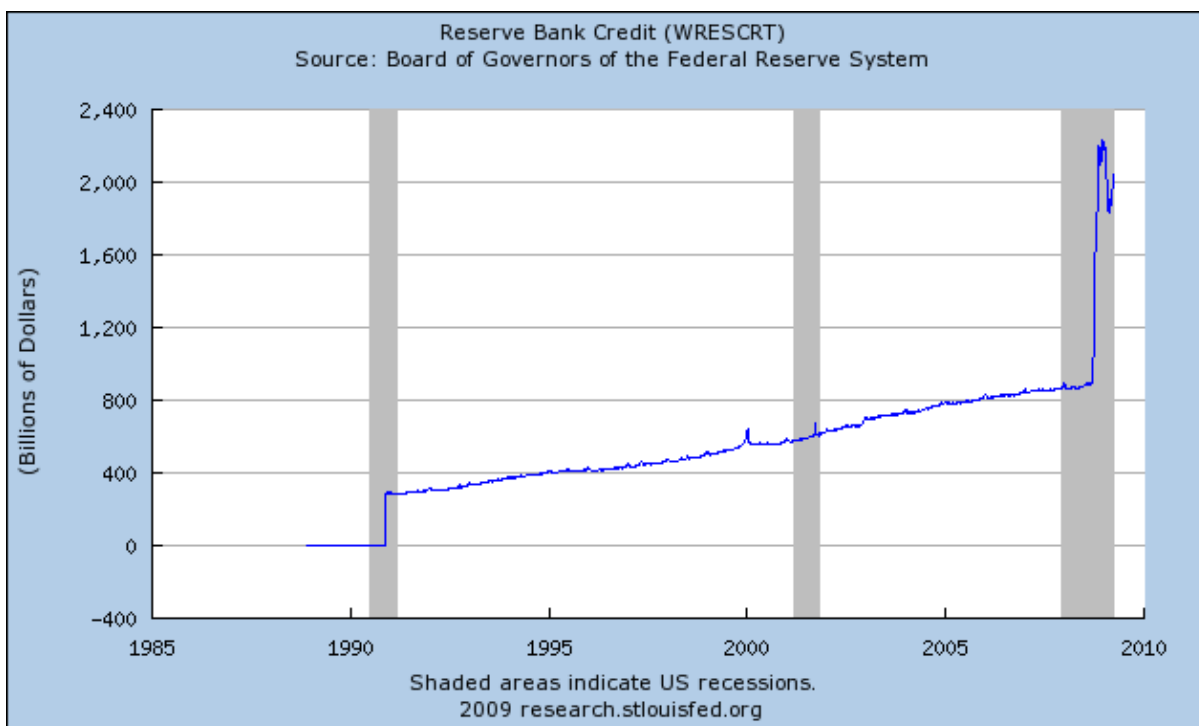
One way to do so is to own assets in emerging market nations. Shares in companies that produce tangible assets is an even better strategy. Australian gold stocks, then, satisfy two needs: you get your money out of the U.S. dollar AND you have exposure to the rising gold price.

In the coming months, we'll update you on these gold shares. We'll also be making more specific gold stock recommendations as the market revives and these stocks recover from deeply oversold territory. Most of them have not yet begun to make a big move up.

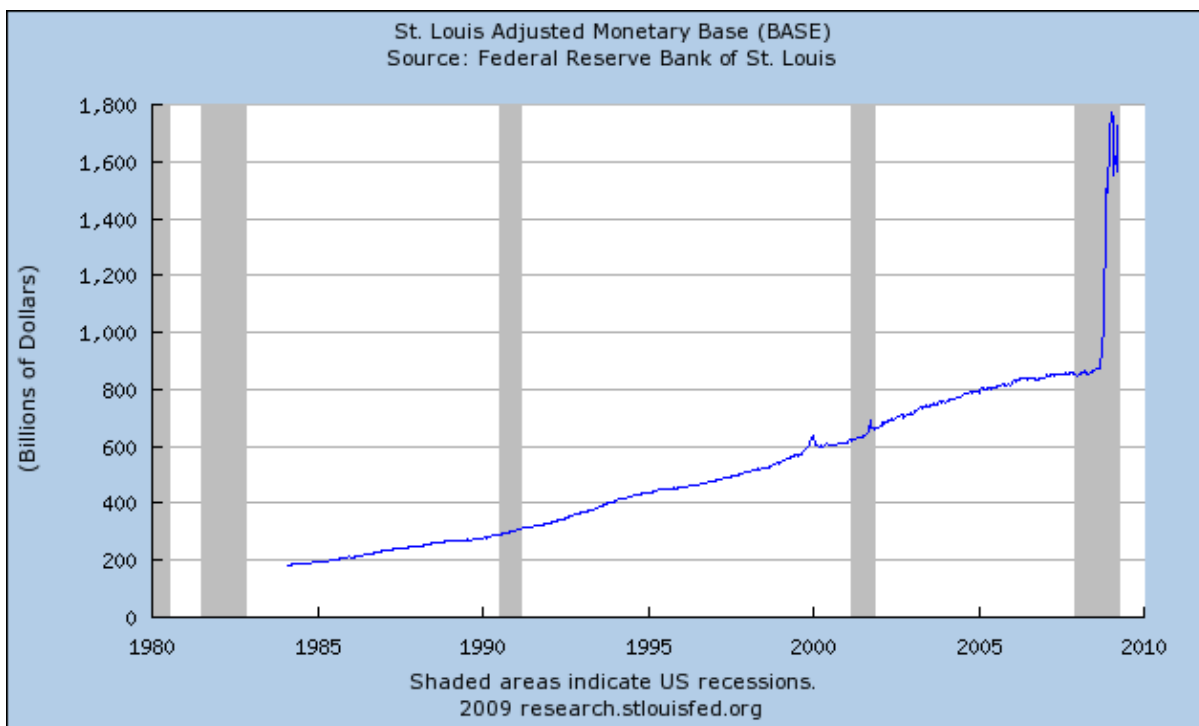
But as the gold price begins to move and the dollar begins to weaken, look for Aussie gold juniors to benefit from. Of course it is possible that U.S. dollar weakness will not translate into a higher gold price. It is further possible that even if the gold bullion rises, gold stocks may not follow.

However, a graphic look at the growth in the money supply and the Fed's balance sheet puts the case for gold in much needed perspective. The inflation that usually accompanies big rises in the gold price hasn't shown up yet in consumer prices. But we believe it will later this year and in 2010.

The Fed's Balance Sheet Explodes

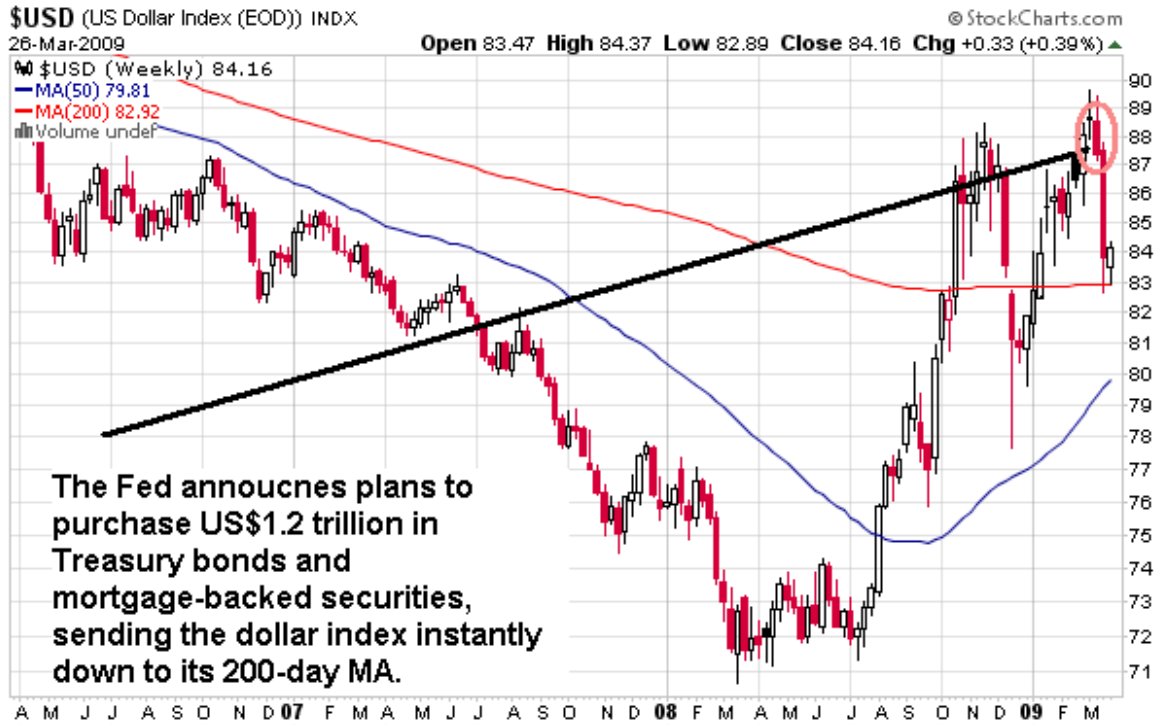


Adjusted Monetary Base Explodes Too





The Dollar Rally is Snuffed Out



Why Aussie Gold Stocks Should Follow the Gold Price Higher

When gold hit a new high of A\$1,535.68 in late February of 2009, it surprised a lot of Australian investors and many international investors too (those who were aware of it). Many investors and most in the media continue to be unaware of gold's role in the financial system and its attractiveness as a hedge against inflation.

Yet as recently as the late 1970s there is ample evidence to show that when government deficits soar and the world economy slows, gold becomes a "safe haven" for investors seeking protection from falling stock prices.

But gold has historically been more than just a safe haven. It's also played a vital role in the monetary system as real money. In fact, you might be surprised to know that the modern world of paper currencies that are not backed by a tangible asset like gold is just over thirty years old. What's more, it may not reach forty! That's one reason gold is making new highs.

Paper Money, Inflation, and Stocks

At the end of this report you'll find three charts which make the case for Aussie gold in pictures rather than words. Sometimes pictures can tell a story better than words. That's the case with these three little pictures and Gold Mania 2009 they seem to predict.

So what are the pictures and why may they indicate much higher gold prices in 2009? A brief introduction...

- 1. Gold in Aussie Dollars Makes a New High:** The first chart shows the gold price in Australian dollars. Though the gold price is quoted internationally in U.S. dollars, what matters to investors in Australian gold stocks is whether it will go up in Australian dollars. The relationship is complicated, but the chart shows gold making a strong run in Aussie dollars as the Australian dollar fell against gold and other currencies. Lower interest rates (controlled by the Reserve Bank) could send the Aussie gold price higher. Other factors like government deficits and a slow economy hurt a currency, too. This supports the case for a higher Aussie gold price. Granted, the chart shows a big move in recent months. Corrections (as low as A\$1,000) may be possible. But in general, we expect gold to rise against ALL paper currencies as the global financial crisis forces governments to go deeply into debt. It will be a crisis in paper money that should benefit the gold price.
- 2. Gold's Inflation Adjusted Price is \$US2,306.83.** The last time the world economy experienced a slowdown, gold prices made a new high of around of US\$850. But those were prices in the 1980s. If gold were to reach the same level today it would be equal to around US\$2,300. Right now, the world's central bankers are warning of deflation and falling prices. But we believe that the huge borrowing programs by the U.S. Federal Reserve, the Bank of England, and the Bank of Japan (not to mention stimulus packages in nations like China and right here in Australia) will lead to much higher inflation in 2009 and 2010. For investors, now is the time to prepare for that scenario by investing in gold and gold stocks. In the short-term, the gold price may fall or stay stagnant, along with share prices and property (look for gold to again dip below US\$900). But in the long-term, history shows that whenever the money supply expands, prices rise. This is what drove the gold price so high in the late 1970s. We believe it will drive the gold price to a new high in the next twelve months.
- 3. Dow Jones Industrials/Gold Ratio May Return to 1:1.** The final chart shows the relationship between gold and stocks when inflation scares people out of shares and into gold. You can see that as stocks soared with the tech boom of the late 1990s, the gold price plummeted. One share of the Dow was worth nearly 44 times more than an ounce of gold in U.S. dollars. But with the collapse of the tech boom and now, the collapse of the credit bubble, the ratio is shrinking again. The last time this happened, an ounce of gold was worth almost the same as a share of the Dow. They met around 850. This time around, we believe the Dow/Gold ratio will again return to one, but with gold rising to meet the Dow around 4,000 (or US\$4,000/oz for gold).

If gold reaches US\$4,000, you can be sure the Aussie gold price will rise much, much higher as well. If it happens, it will mean the credit crisis has turned into a full-blown economic crisis (possibly even a depression). If that happens, stocks will certainly fall and investors will need a way to store and preserve their wealth.

In 1980, at the dawn of the real gold junior explosion, investors pocketed gains as high as 13,000%. Gold juniors are similarly placed today as they were in 1979. Except today, you have a much less daunting market to invest in. Gold juniors took serious punishment in 2008.

They lost more than a third of their market value. That, combined with the remarkable potential for the gold price this year, makes it a great time to look at the gold junior market. So here are five of the best as we look at the market in early 2009. Make sure to stay tuned to your monthly reports and weekly updates from Diggers and Drillers to stay current.

Kingsgate Consolidated

Kingsgate (ASX:KCN) has been in transition for two years. This has been due to prolonged permit issues with its Chatree North deposit, a situation worsened by ongoing political unrest in Thailand.

But Kingsgate's CEO Gavin Thomas recently commented on this: "We have operated in Thailand for many years with many different governments and it has never impacted on our operations."



Kingsgate recently announced the completion of the permitting process, paving the way for production to ramp up as it sources ore from the newly developed C North pit. Target annual production for fiscal 2009 is 100,000 – 140,000 oz. A target cash cost of US\$350/oz will place the company in the lowest quartile of cash costs for producing gold mining companies.

Kingsgate's success in Thailand is largely attributable to wonderful infrastructure including grid power costing just US\$0.06 - \$0.07 per KWH. By comparison, Australian companies pay \$0.25 - \$0.40. More importantly, KCN boasts an unrivalled social accountability record with a 99% Thai workforce.

That will go a long way to maintaining a good relationship with Thai officials.

Exploration potential is enormous too, with the recent discovery of Chokdee. It's located 20km north of Chatree in the central Thai gold belt. Gavin Thomas comments: "This discovery has the potential for a new Chatree-size gold system or even larger."

With **no debt and a strong balance sheet** Kingsgate is well positioned.

Troy Resources

Troy Resources (ASX:TRY), like Kingsgate, is at the tail end of a transition stage. It ceased production on its highly successful Sertão mine in Brazil (July 2007). The next development asset is the Brazilian Andorinhas gold project. Troy bought this from Agincourt in November 2006 for just US\$10m.

The project has a small open pit component called Lagoa Seca and a bigger underground ore body called Mamão. Lower grade ore is mined from Lagoa Seca and stockpiled. This will be supplemented with higher grade Mamão ore later on. That should see modest annual production of 50,000 oz, at a life of mine average cash cost of US\$300/oz.

The initial mine life is five years with the expectation of extending this, given Mamão remains open at depth. Troy Resources has a strong balance sheet. It owns A\$60m in cash and investments equating to Net Financial Assets of A\$0.85 a share.

Troy's current price of \$1.27 is a low-risk entry point. In addition, Troy has a commercially viable iron ore deposit at Andorinhas as well as a processing plant on care and maintenance, targeting a joint venture partner. There is also the Sandstone gold project in Australia.

At current domestic gold prices, this could produce for another 12 months at higher cash costs. Troy has just 70m shares on issue with directors owning 14% and has impressively paid an annual dividend for 9 consecutive years. It has cash, quality gold assets, and a good price.

Dominion Mining

Dominion Mining (ASX:DOM) has come a long way in a very short space of time. DOM's Challenger project in South Australia started life in 2002. It was a small open pit operation with just 112,500 oz in reserves. As the project evolved into an underground mine, further exploration drilling built reserves to well over 700,000 oz and an annual production rate of over 100,000 oz.

Challenger is now the benchmark for Australian underground mines. The plan for 2008/09 is to increase reserves to 1 Moz, whilst maintaining annual production at 100,000 oz. With cash costs including royalties of A\$457/oz (US\$300), Dominion remains one of Australia's lowest cost producers.

Here's a tip though. Underground projects can be expensive from a capital cost perspective. So it's important to account for Challenger's annual capital expenditure when calculating the Entry Level. This was A\$265/oz in 07/08, a steady figure. Even better, Dominion pays you to own it. It gave out an annual dividend of \$0.12 out of earnings per share (EPS) of \$0.325 last year, representing a 37% distribution.

Silver Lake

Silver Lake (ASX:SLR) is a new comer to the Australian gold scene, listing on the ASX in late 2007. But the company team is experienced. It contains many former **Western Mining** nickel division employees. CEO Les Davis has 30 years industry experience involving a lot of underground nickel mining using narrow vein techniques. Why is that relevant?

Well, Silver Lake bought the old Daisy-Milano underground mine and Mount Monger ground east of Kalgoorlie in Western Australia. Western Australia is Western Mining's old stomping ground. Right now the Mount Monger goldfield has had little exploration at depth. But it has excellent potential for new underground discoveries.

Shortly after floating, Silver Lake also acquired the 300,000 t/annum Lakewood Gold processing facility located 45 km from Daisy Milano. Ore production from the mine commenced soon after. As at 30 September 2008, the total resource at Daisy Milano was 250,000 oz at an amazing grade of close to 1 oz/t. This formed the basis of a 5 year mine plan at an annual production rate of 35,000 – 40,000 oz.

In the September 08 Quarter, Silver Lake produced 8,670 oz at a cash cost of \$A687/oz. It's not the cheapest mine in Australia at the moment. Managing Director Les Davis said in an interview with HighGrade in May, "I think our biggest challenge at the moment is diesel, we budgeted A\$1.20/litre for diesel and the bowser price is A\$1.70, so we're \$0.50 a litre over."

But Davis maintains that if Silver Lake can keep up production of 3,000 oz/month, cash costs will fall below \$A500/oz. With the average price of diesel now under A\$1.50/litre this cash cost seems achievable.

Independence Group

Independence Group (ASX:IGO) is an established nickel producer. But it also has a 30% interest in one of Australia's most significant gold discoveries for many years. Tropicana comprises 12,260 sq km of largely unexplored land over a strike length of 350km along the Yilgarn Craton in Western Australia. The JORC resource as it stands is over 4 Moz.

Independence's share is 1.2 Moz: AngloGold holds the remaining 70% and is conducting a prefeasibility study on the project. That's good news. Independence is getting a free ride on the completion of this study. The conceptual plan is to build a mine producing 300,000 oz a year for a minimum of 10 years.

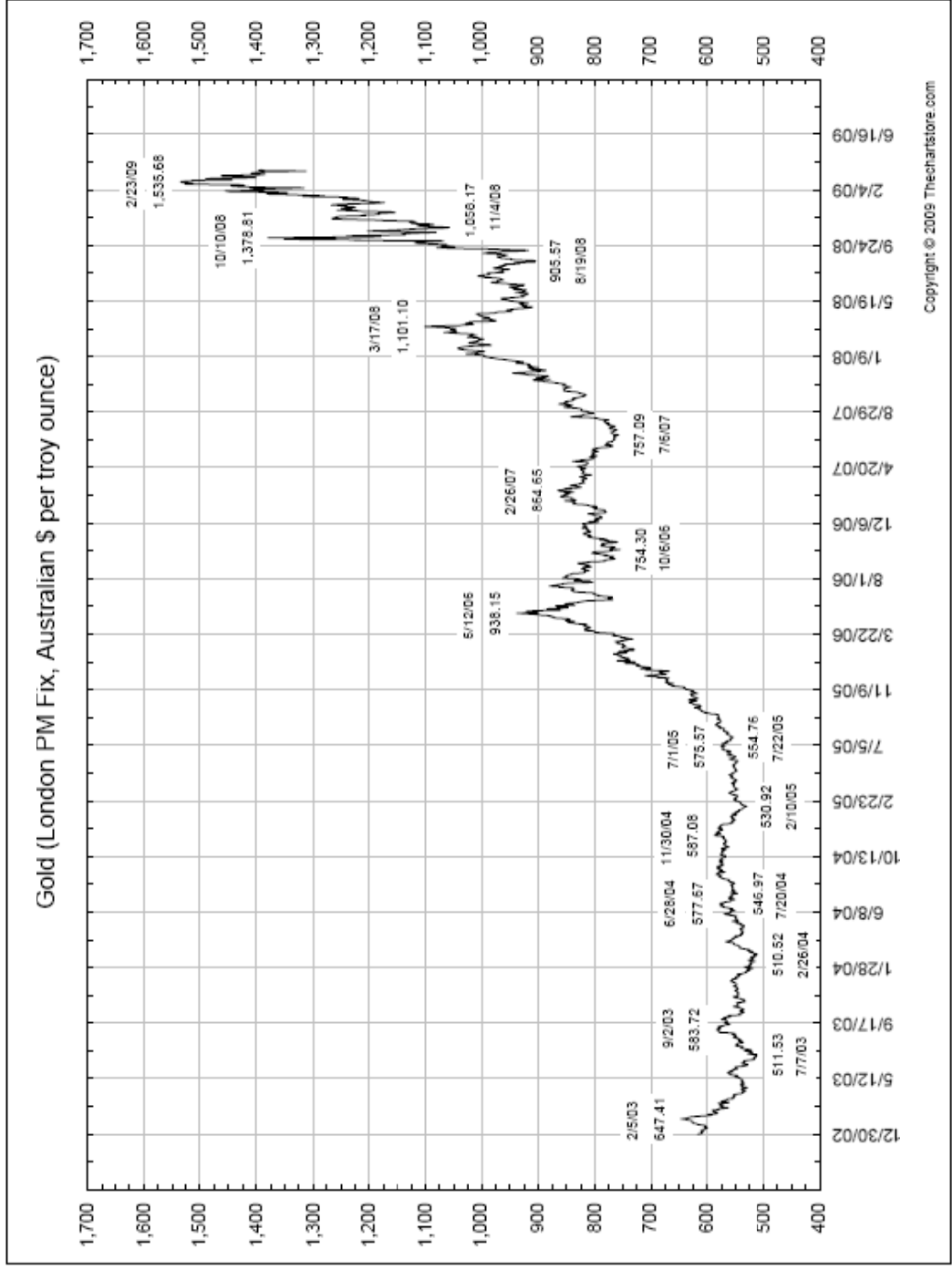
The probability of growing the resource base is very high with little exploration undertaken at depth. With the cost of steel, labor and fuel falling in recent months, the odds of a favorable development decision are firming.

The company paid a dividend last year of \$0.17 out of Earnings per share (EPS) of \$0.44, representing a 38% distribution. It may be a nickel miner now, but Independence has a firm grip on one of the most promising gold projects in the country.



The Gold Price sets a New High in Australian Dollars

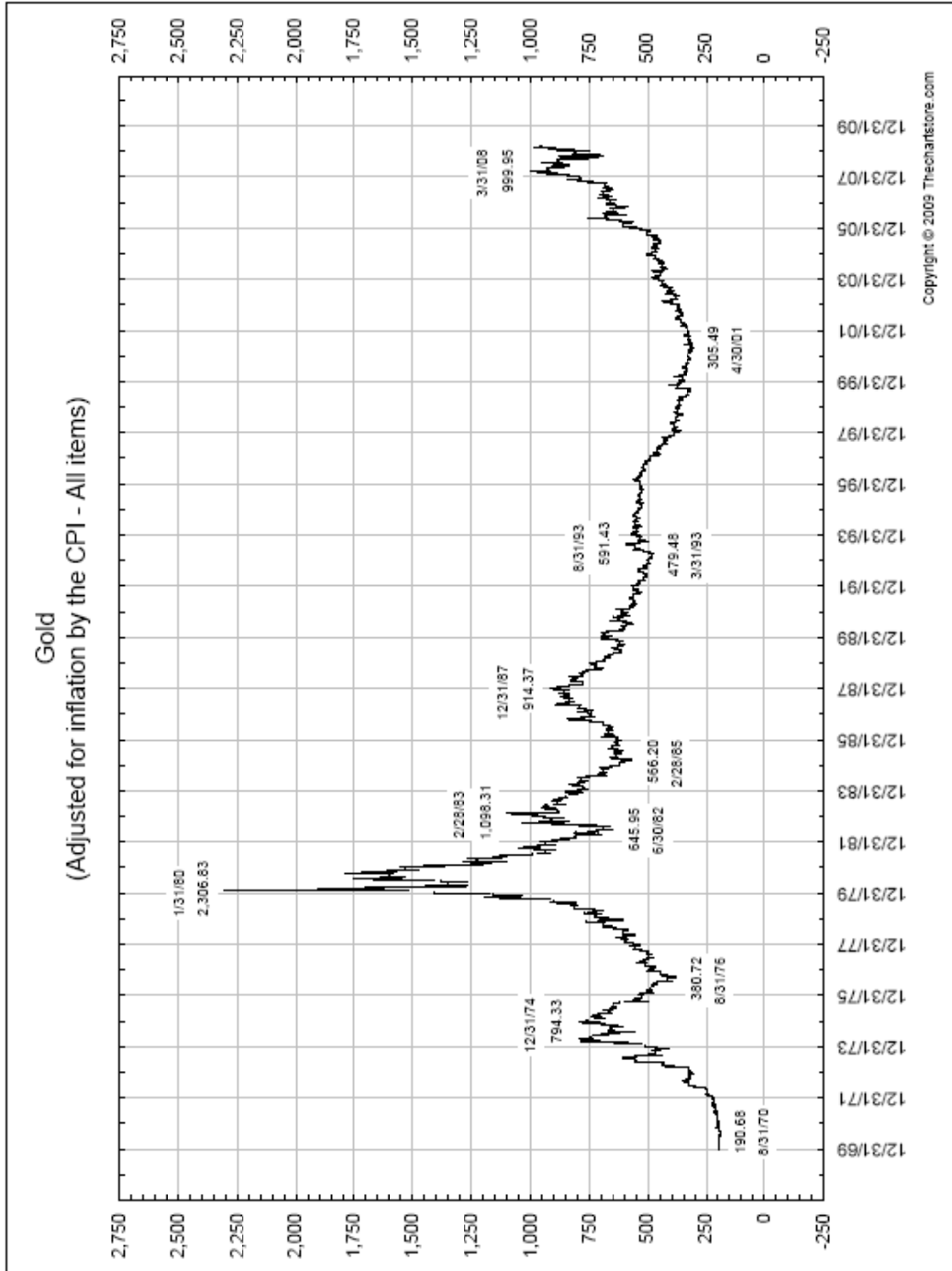
Data as of March 20, 2009



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Gold's Inflation Adjusted High in U.S. Dollars is \$2,306.83

Data as of February 2009

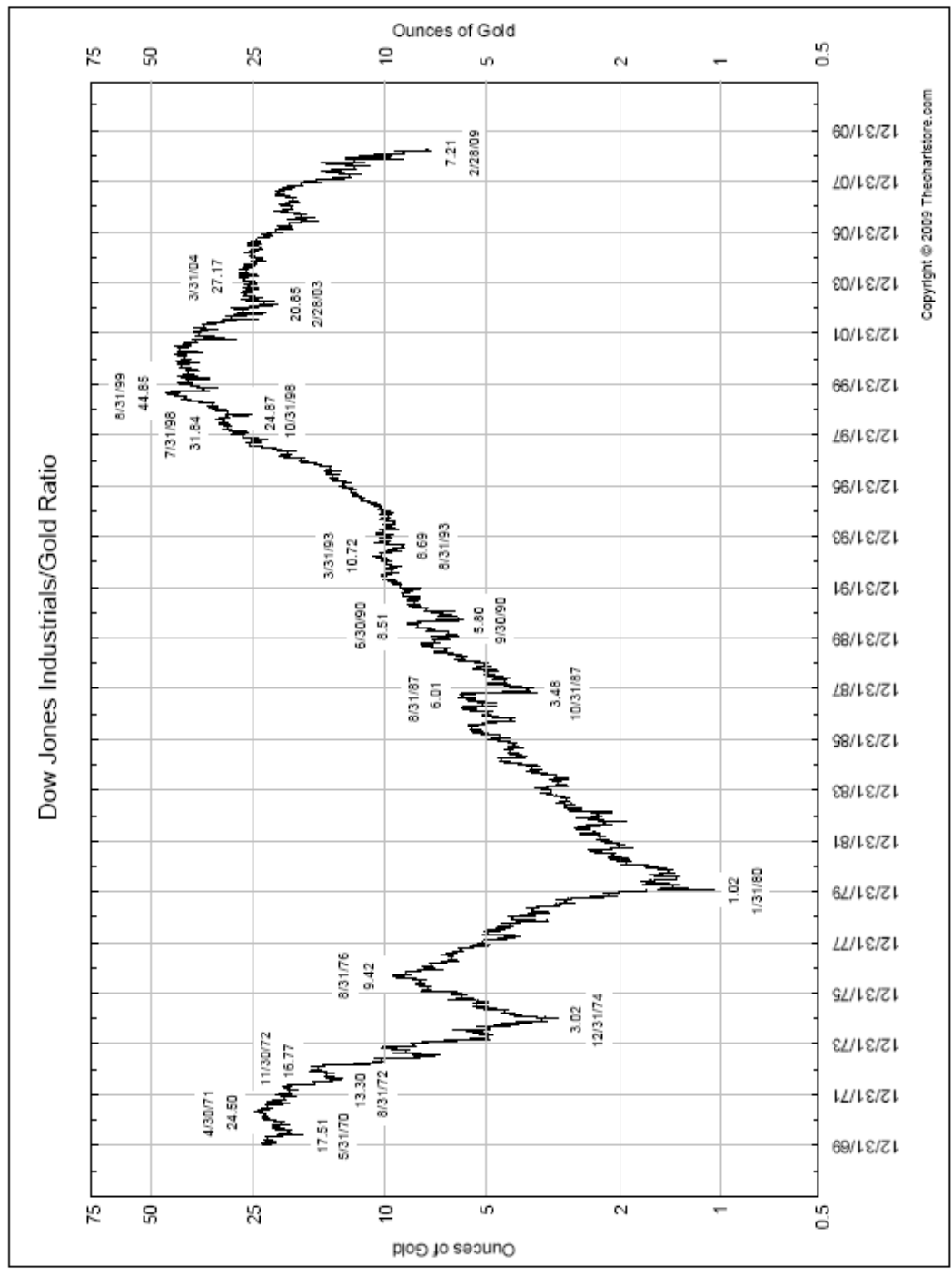


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The Dow Jones Industrials/Gold Ratio May Be Headed to 1:1

Data as of February 2009



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