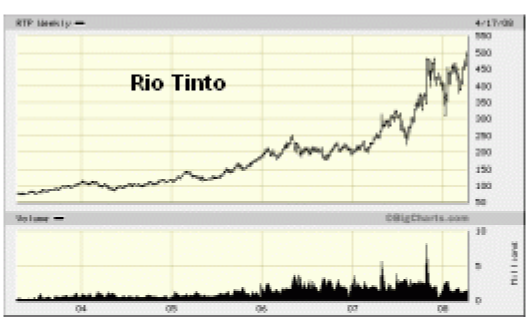
Tracker 2008-17

April 18, 2008

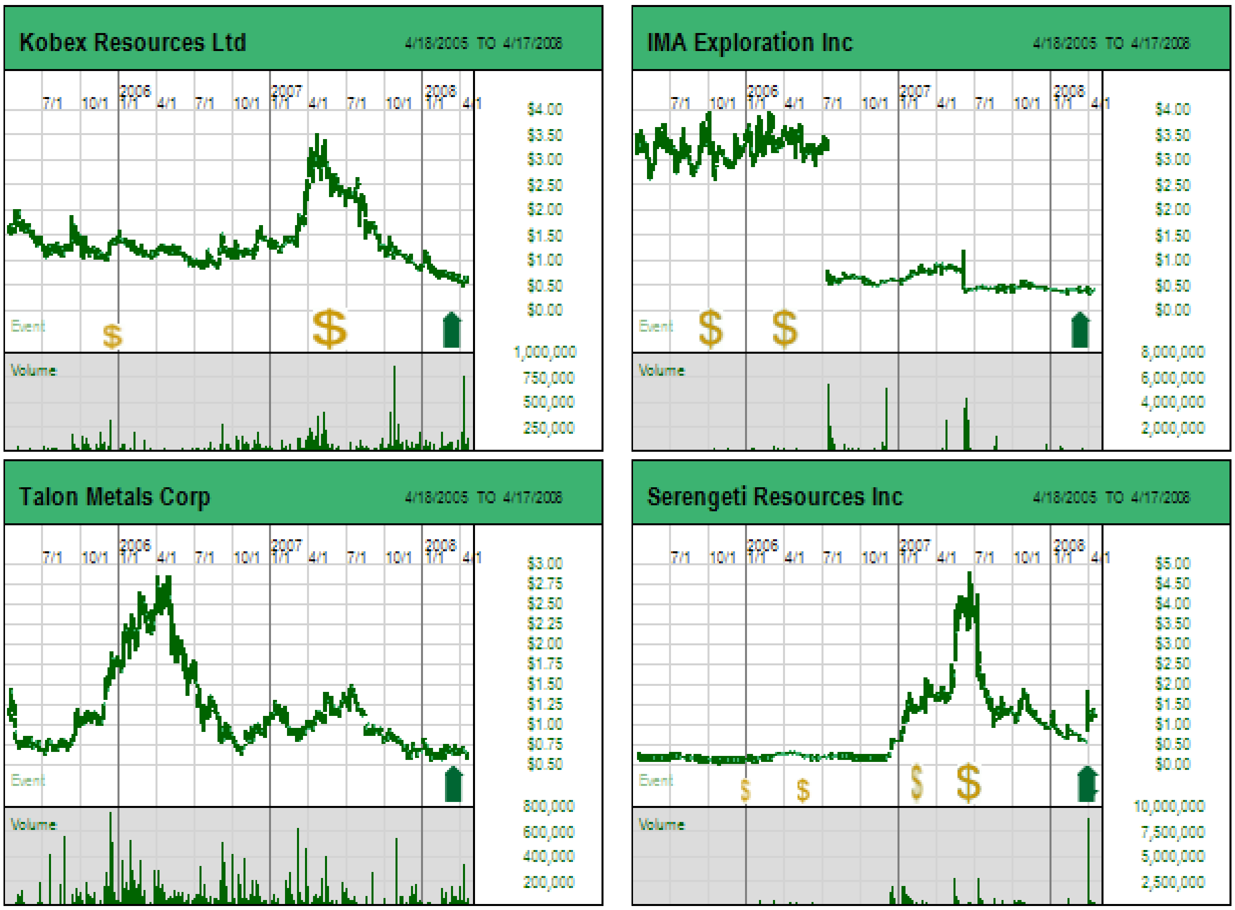
Skeena Resources Ltd (SKE-V: $0.27)

PGM Tropico and Cu-Au Malpica projects turn Skeena into a Secular Bull bet

Synopsis: At the Cambridge Conference in Calgary on April 12, 2008 I gave a speech discussing the disconnect between metal prices and the market's valuation of the junior resource sector. Copper, the bellwether metal of the business cycle, was above $4 per lb and inching into new record price territory. Platinum, the ultimate symbol of footprint consciousness thanks to its critical role as an emission control agent, was holding up in its newly attained stratospheric orbit above $2,000 per oz. Gold was holding at $900 plus after being brutally pummeled in the wake of breaching the watershed $1,000 per oz mark. And yet the juniors with pounds or ounces in the ground were being crushed towards ever lower prices by seemingly endless gobs of paper lobbed from an anonymous darkness. Yes, there are more zeros attached to the current subprime induced credit squeeze than we saw in 1998 when the Russian debt default caught Long Term Capital offside and forced an Atlas shrugging mumbo-jumbo master to orchestrate a rescue that propped up the dominoes. But are the juniors REALLY the proverbial canaries in the coal mine whose croaking signals the inevitability of the worst case outcome? Much as I would like to think that the tiny sector in which I specialize represents the key to predicting the future, I'm inclined to suspect that there is a fundamental disconnect between the pain being suffered by the juniors and the reality palpable in the prices of raw materials themselves and those of the bigger suppliers such as Rio Tinto and BHP. The theme of my speech was that the category five hurricane created by the death of the securitized mortgage paper market was severely bending the resource juniors like saplings in the wind, but no hurricane lasts forever, and when the wind dies down the saplings will snap upright and grow with a vengeance under blue skies no longer shrouded by yesterday's pulp and paper giants. There may be the odd toppled oak like Bear Stearns that will never stand tall again, but the few oaks remaining in the resource sector after a decade of consolidation never budged. What I could not conscientiously predict to my full-house audience in Calgary was WHEN the hurricane would subside, but what I could pound the podium about was the prediction THAT the resource juniors WILL experience an extraordinary bull market of the sort that occurs only once in a generation WHEN this hurricane winds down.



As a risk adverse person who too often has to grapple with the self-acknowledgement that "I just don't know", I have recommended that bottom-fishers stick to accumulating cash rich juniors trading not too far above their cash breakup value and which have management that not only has a track record of success but which is still focused on improving that track record. I have introduced as new bottom-fish buy recommendations cash rich companies such as **Kobex Resources Inc (KBX-V: $0.62)**, **IMA Exploration Inc (IMR-V: $0.415)**, **Sennen Resources Inc (SN-V: $0.345)**, **Talon Metals Corp (TLO-T: $0.61)**, **Northern Lion Gold Corp (NL-V: $0.34)** and **Serengeti Resources Inc (SIR-V: $1.24)**. These are no-brainers that you just buy and tuck away while you hang out in your basement and keep the doors shut lest you get whisked away like Dorothy and her mutt into the Land of Oz. But there are other not so cash rich juniors with competent management and intriguing stories that would do really well if the inflection happens and raw materials prove to be the mania of the next decade. Do I dare take the leap?



During the eighties I had the privilege of meeting a remarkable individual called Keith George who had lost his arm in Vietnam. After that pointless war he moved to Canada and became a prospector. He told me how one night he got caught on a mountain without a flashlight. One armed and now also blind he worked his way down the side of the mountain until he came to what was clearly a ledge. He groped around until he found a pebble, dropped it over the edge, and counted what he imagined were seconds until he heard a plop and then a disturbing series of additional noises. He squared the time and multiplied it by 10 to come up with a not particularly comforting number, and decided what mattered was that there was a bottom. So he dropped himself over the ledge, and all that I can say is that he did not tell me this story while sitting in a wheelchair. Keith eventually moved back to the United States where the last I heard from him was that he was trying to reopen an old silver mine called Hackensack, and finding himself periodically compelled to shoot holes in the clouds with his AK47 in order to cool down a neighbor who was alternating between expressing disapproval and cultivating strange smelling green stuff in the nearby hills.

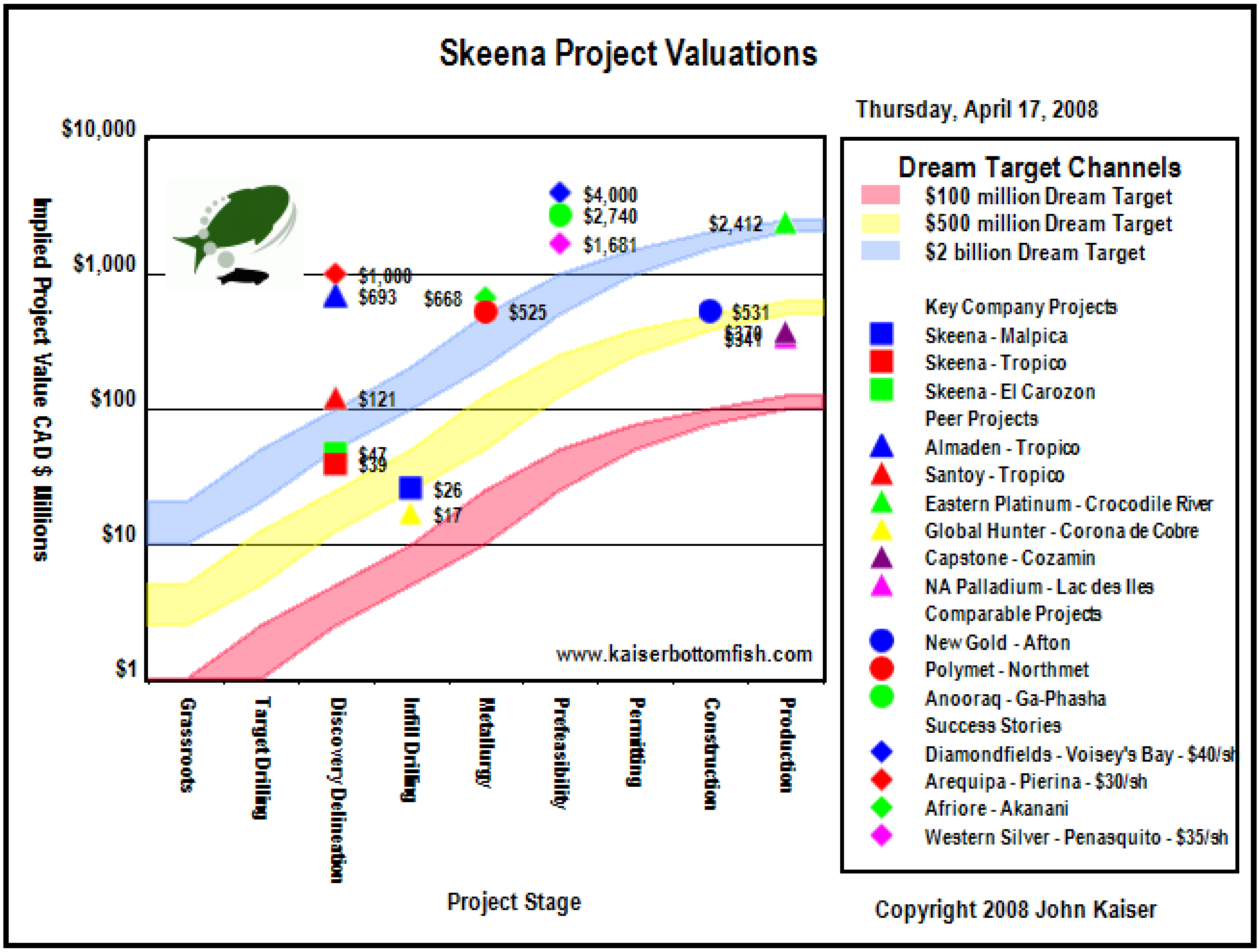
The moral of the story is that sometimes when you don't know for sure you just have to take a leap, and what I don't know for sure is that China will weather an American economic downturn and in doing so will cause metal prices to stay at elevated levels for a very long time. What I do know is that if this optimistic scenario proves to be the case, there will be a mania for juniors with advanced pounds/ounces in the ground whose race to production the market will fund with a vengeance. In this context I am recommending as a top priority bottom-fish buy in the $0.20-$0.29 range a junior called **Skeena Resources Ltd (SKE-V: $0.27)**. Or, better said, **I am upgrading to top priority buy a junior that has had an open bottom-fish buy cycle in the $0.20-$0.29 range since December 1, 1997** when I had not yet invented a priority system of top, medium, low and extreme risk to rank how long it might take to get the requisite 500% plus bottom-fish gain that is an implicit expectation in every bottom-fish buy recommendation. (The "Extreme Risk" priority ranking, reserved for stocks below $0.10, used to be called "Dumpster Diving", in my view a very respectable "green economy" activity, but I changed the nomenclature when it became apparent that management of the dumpster diving target was not overly appreciative of my recommendation.)

On February 15-16 I had the opportunity to visit two new projects that Skeena Resources Ltd has taken on during the past year, both of them less than an hour's drive from Mazatlan on the west coast of Mexico. Apart from a rally to $1 in 2006 on heavy volume inspired by Skeena's El Corazon gold project in Ecuador, which attracted the attention of German speculators enamored with Aurelian's 14 million ounce Fruta del Norte gold discovery until the surprise election of Rafael Correa in late 2006 plunged Ecuador's resource projects into a deep well of uncertainty, Skeena has spent the past decade flip flopping from one regional or commodity focus to another. Skeena still has a 50% option on El Corazon, whose flashy intersections defy being tied together into a meaningful resource, but this option requires a major $4.5 million balloon payment at the end of 2008. Given the uncertainty over the mining sector in Ecuador, especially in view of implications within the April 15 published draft of the proposed mining law which apparently envisions a state owned mining company owning all major deposits and negotiating project management deals with interested foreigners, none of which will be negotiable until the end of a 180 day moratorium on exploration activity, one can assume that Skeena will exit Ecuador. The company certainly has received an abundance of calls from shareholders asking if Skeena still owns the Ecuador project, and, upon hearing that Skeena does indeed still have the option to own the project, these shareholders have encouraged management to drop the option pronto in order to eliminate any "Ecuador discount" that Skeena might still be suffering.

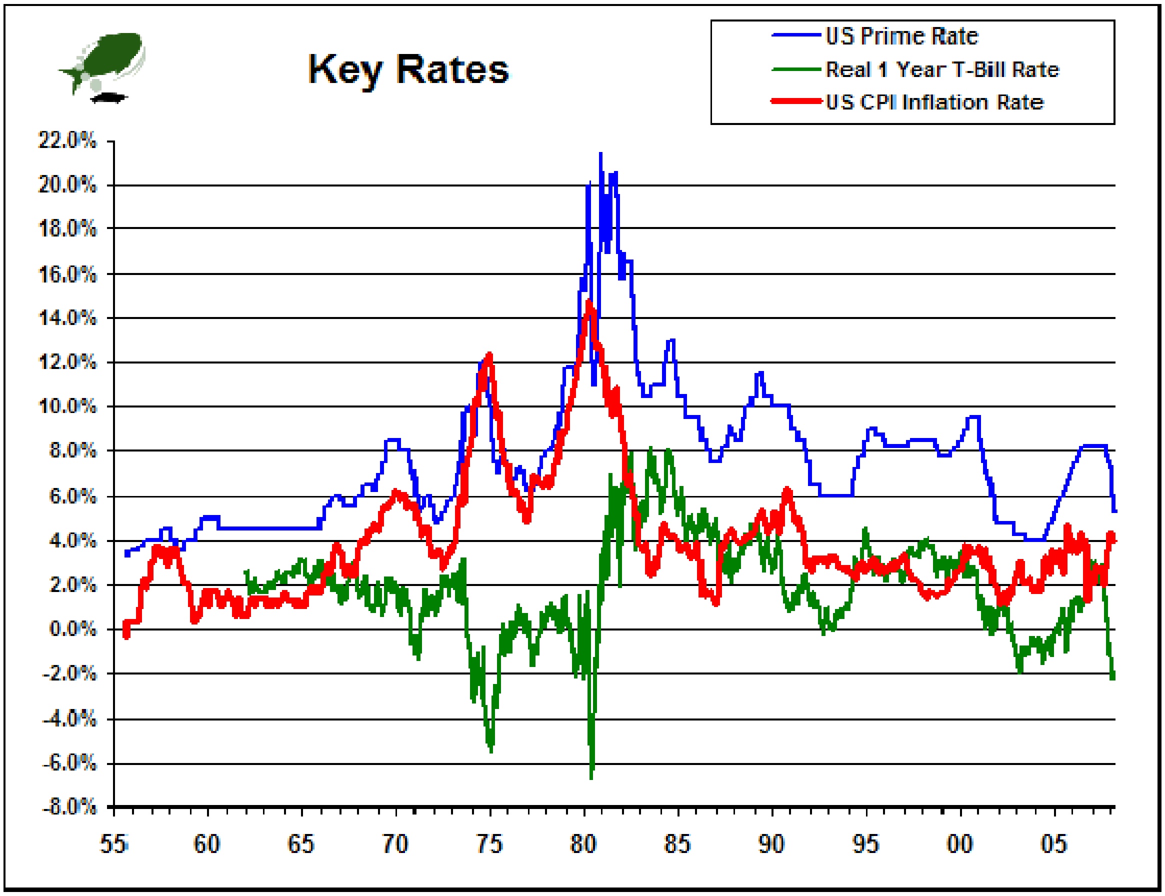
Having missed the opportunity to issue a sell during the Ecuador promotion of an ill-fated project recycled from an earlier bottom-fish called Balaclava that has since been absorbed into Simon Ridgeway's Radius Gold, I had contemplated flushing Skeena down the toilet last year with a "Bottom-fish Dud Closeout Sell 100%" recommendation when I got a call from Rupert Allan to take a close look at a new advanced copper project Skeena had optioned from the group that had sold the La Negra polymetallic project to **Aurcana Corp (AUN-V: $0.69)** in 2006.

Skeena's 90% Malpica option involved a one year due diligence period that would end in May 2008, at which point Skeena would have to commit to a series of three year payments to the intermediary and the underlying owner Grupo Mexico. Skeena must pay Grupo Mexico US $1 million within 12 months of electing to proceed with the option, $2 million in 18 months, $3.75 million in 24 months and $3.6 million in 36 months. Skeena must have Malpica in production at a rate of 1.5 million tonnes per year (5,000-6,000 tpd), though this deadline can be extended through a modest advance royalty payment. Grupo Mexico retains a sliding scale royalty and a right of first refusal on the concentrates. The intermediary, Reyna, will receive $525,000 upon Skeena electing to proceed, another $225,000 one year later, 1 million two year warrants exercisable at $0.75, and 5 million shares in stages. This gives Skeena 90% of Skeena Mexico SA de CV which will hold the option. Reyna is carried for the first $7.5 million exploration, and if it does not contribute its subsequent pro-rata share, Skeena can buy the 10% for US $2 million.

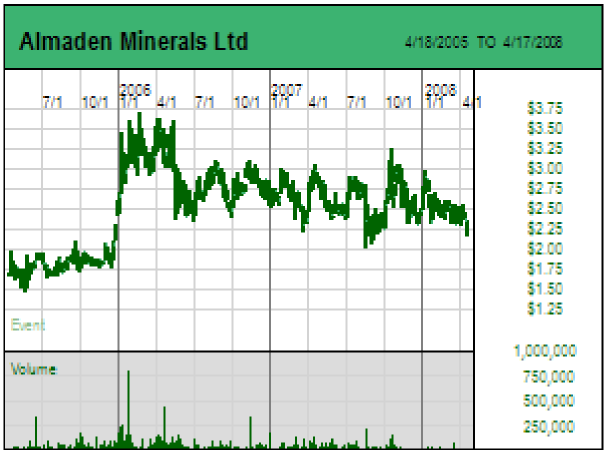
My property visit during February occurred during the midst of a drilling program designed to confirm grades of the known copper-gold breccia system and test a northerly extension on ground that had not been available to a previous operator. On April 14 Skeena reported the first 10 holes of a 35 hole drill program which confirmed the grades of holes drilled by ASARCO and Cambior in the main zone, and established that a geophysical anomaly on ground to the north that had previously been unavailable for drilling did indeed represent an extension of the known zone that could add at least 3-5 million tonnes to the resource. The results also demonstrated an important level of molybdenum mineralization which had not been assayed for by the previous operators, likely because of low molybdenum prices at the time, and which, in the context of a molybdenum soil geochemical footprint covering the entire Malpica system, suggests that these recent molybdenum grades will map to the 30 million tonnes estimated for the two breccia pipes. Skeena management, headed by Rupert Allan and Ron Netolitzky, does not have a 43-101 compliant resource to deal with at this stage, but has indicated that in its view the known resource is reasonably reliable, with improvement possible for the gold grade through denser drill spacing that includes angle holes designed to deal with the fabric of the gold mineralization. However, Skeena feels that it does need to expand the known resource by 15-30% to achieve a critical mass in terms of a mineable resource that justifies development of a modest 5,000 tpd open pit milling operation. At current metal prices the copper-gold grade in the 30 million tonne resource represents a rock value of $50-$60 per tonne with an overall in situ gross metal value of $1.5-$1.8 billion. The molybdenum credit, if follow up drilling confirms a correlation with the copper grade within the overall resource implied by soil geochemistry, would boost the GMV 25% at the current molybdenum price of $30-$35 per lb.



Skeena is now sufficiently confident about Malpica that it will proceed with the option in May which requires it to turn the breccia system into a mine within 3 years, a timeline that sounds scary in this age of permitting delays, but which in reality can be extended through nominal advance royalty payments. Malpica is not a huge project; I estimate its dream target value to be a value in the $100-$200 million range with an in situ copper-gold-molybdenum gross value in the $1-$2 billion range if Malpica wins the race to production in a context where metal prices stabilize at levels no worse than 33% below current levels. Depending on how much dilution Skeena suffers to complete the Malpica race to production, the upside based on Malpica is 300%-600% from current levels, which suggests a price target in the $1-$2 range. That may not be particularly impressive given the uncertainties involved, but given the alternative of less than 2% yield for a 1 year treasury bill on which one must pay tax, even though the US inflation rate is 4% and growing, implying a rot of a least 3% of one's capital in terms of purchasing power (not to mention exchange rate losses), I am inclined to favor Skeena's tripling potential over the guaranteed incremental diminishment of my capital. The rule these days is, if you cannot afford to lose a lot of money by putting your money into something that could make you a lot of money, put your money into something where you know your real losses will be in the single digits. This dreary strategy is demonstrated by the chart below which shows the negative real rate of return 1 year t-bill investors are experiencing.



Fortunately, Skeena offers more than a naked bet on the theory that the United States is not an anchor that will drag the rest of the world to the bottom of the sea. While Malpica is a Plan A type "race to production" story where the bet is that copper-gold-molybdenum prices will in the long run not collapse to bear market levels that prevailed prior to 2003, Skeena also has a new Plan B type "bluesky" exploration story in the form of the Tropico project it optioned from a related company in February. Tropico is an old platinum-palladium-copper story that excited hopes for Almaden and Santoy in 1999 when palladium had soared to $1,000 per oz in the wake of a Russian supply manipulation. But the project ended up on the shelf after palladium collapsed in 2000, drill results yielded weaker assays at depth than had been trenched at surface, and the Japanese joint venture partner, Sumitomo, pulled out. Since then Santoy has gone on to become a uranium exploration vehicle, and Almaden has entrenched itself as a prospect-generator-farmout junior which will never risk a nickel of its $20 million working capital on testing the merits of the prospects generated by the father-son team of Duane and Morgan Poliquin. I should not, of course, be critical, because Almaden has had an open bottom-fish cycle since at least as long as Skeena, is up considerably from initial levels, and will end up still higher if the resource sector perceptual inflection that Paul van Eeden disagrees is even conceivable does indeed happen. But I kick myself for favoring a farmout machine such as Almaden whose farmed out flagship Caballo Blanco keeps delivering what pretty much amount to El Blanco results, while an antifarmout-prospect-generator like **Canplats Resource Corp (CPQ-V: $3.27)** that I have perennially disdained as a go-nowhere wheel-spinner toiling geologist junior delivers a prospect from scratch that is very similar to the San Agustin project of Geologix and which even the cautiously unoptimistic Brent Cook is recognizing as a winner before such coronation is a fact.



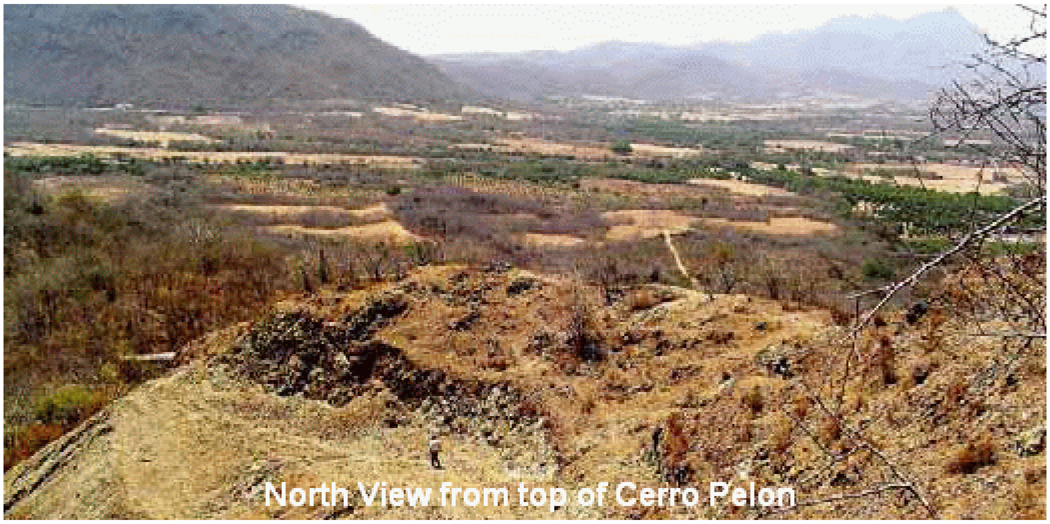
While the Plan A race to production Malpica project offers modest upside in a scenario where copper spends quite a few years above $3 per lb, considerably greater upside is offered by the Plan B exploration bluesky of the Tropico project Skeena optioned on February 18 from a related company. Skeena can earn 60% of Tropico from Santoy and Almaden, who explored the project in 1999-2003 with the help of Sumitomo's money before losing interest due to low metal prices. Tropico is a large layered mafic intrusive complex with widespread copper-platinum-palladium-gold values. The project represents unfinished business for the geologists who worked on it because the plug was pulled before anybody had a chance to sort out the geometry of the system and its mineralization. In light of today's metal prices Tropico merits a fresh look at the possibility that it hosts mutliple large, open pit mineable deposits. Skeena's Rupert Allan and Ron Netolitzky have reassembled the land package and plan to hit the property with a combination of airborne geophysical surveys and a 40 hole 7,000 metre drill program at a cost of $1.5 million. Tropico may not get drilled in 2008, but it does represent a major bet on the prospect that South Africa will not solve its energy shortfall problem any time soon, and, heaven forbid, that growing ethnic tensions between the Zulus and Xhosas, both black tribal groups, will be brought to a flashpoint by electricity shortages.

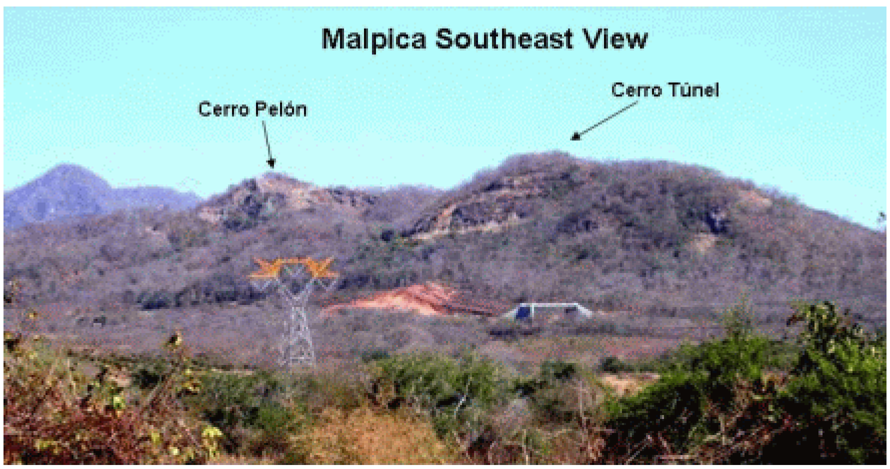
Skeena's $2.5 million working capital as of September 30, 2007 will be gone by the end of Q2 2008 if it proceeds with the Malpica option thanks to payments required by the intermediary. In light of recent drill results Skeena announced a non-brokered $3 million private placement of 10 million units at $0.30 on April 16, 2008 that would boost fully diluted capitalization to 86,892,314 shares. In implied project value terms this assigns to the 90% optioned Malpica project an IPV of $26 million, and to the 60% optioned Tropico project an IPV of $39 million. Given the calibre of management, the advanced stage of Malpica as a Plan A style race to production play, the bluesky potential of the PGM-copper Tropico play, and the Plan C capacity of management to pull a rabbit out of the hat and hand it to Skeena if necessary, these implied values leave lots of room for upside. The Plan A-Plan B structure of the story also leaves open the possibility that Skeena could spin off Malpica into a separate entity if it reaches the stage where it is a possible acquisition target for a mid-tier copper producer. The Malpica option does require Skeena to pay US $11,250,000 (remember the days when "US$" denominated obligations were a worrisome thing for Canadian juniors?) in stages beginning in May 2009 with $1 million to Grupo Mexico, but these payments are staged well enough to represent a nominal premium to pay for a bet on copper prices.

Management claims that at least two-thirds of the financing is spoken for, with the rest to be wrapped up during the next couple of weeks. The stock is trading below the private placement price of $0.30 per unit. Each unit includes a half-warrant, one of which is required to buy a share at $0.40. If Skeena closes at $1.00 or higher for 10 consecutive after the end of the four month hold, the expiry will be accelerated to 25 days from the day of notice. These terms are reasonable in that if Skeena is trading at $1.00 plus four months from now, bottom-fishers will be most pleased. My official recommendation is that bottom-fishers buy Skeena in the $0.20-$0.29 range. My bigger picture recommendation is that we will see drastically higher market prices during the next 18 months for juniors, which can be interpreted as a case for buying the private placement units directly. I do not receive any compensation from Skeena apart from property trip expense reimbursements, so which route bottom-fishers take is irrelevant to me.

Background on Malpica Geology

The economic focus of the 7,718 ha Malpica project are two tourmaline cemented, granodiorite hosted breccia pipes that stand out as prominent hills called Cerro Tunel and Cerro Pelon. Copper, gold and molybdenum mineralization occurs within the tourmaline rich breccia matrix and with veinlets of tourmaline and quartz in fractures within the granodiorite. The dominant sulphide beneath the oxide cap is chalcopyrite. A non-43-101 compliant "proven and probable" resource of 29 million tonnes of 0.51% copper and 0.4 g/t gold was reported in 1996 by Cambior, the last operator to conduct major work on the project. Cambior also calculated an oxide resource of 8 million tonnes grading 0.8% copper, 1.01 g/t gold and 5.26 g/t silver which forms part of the bigger resource. Management attributes the better gold grade in the oxide resource to the greater density of shallow holes drilled by Cambior, which forms the basis for hopes that infill drilling that includes angle holes will boost the gold grade at Malpica. The relationship of the gold mineralization to the copper mineralization is at this stage not well understood.

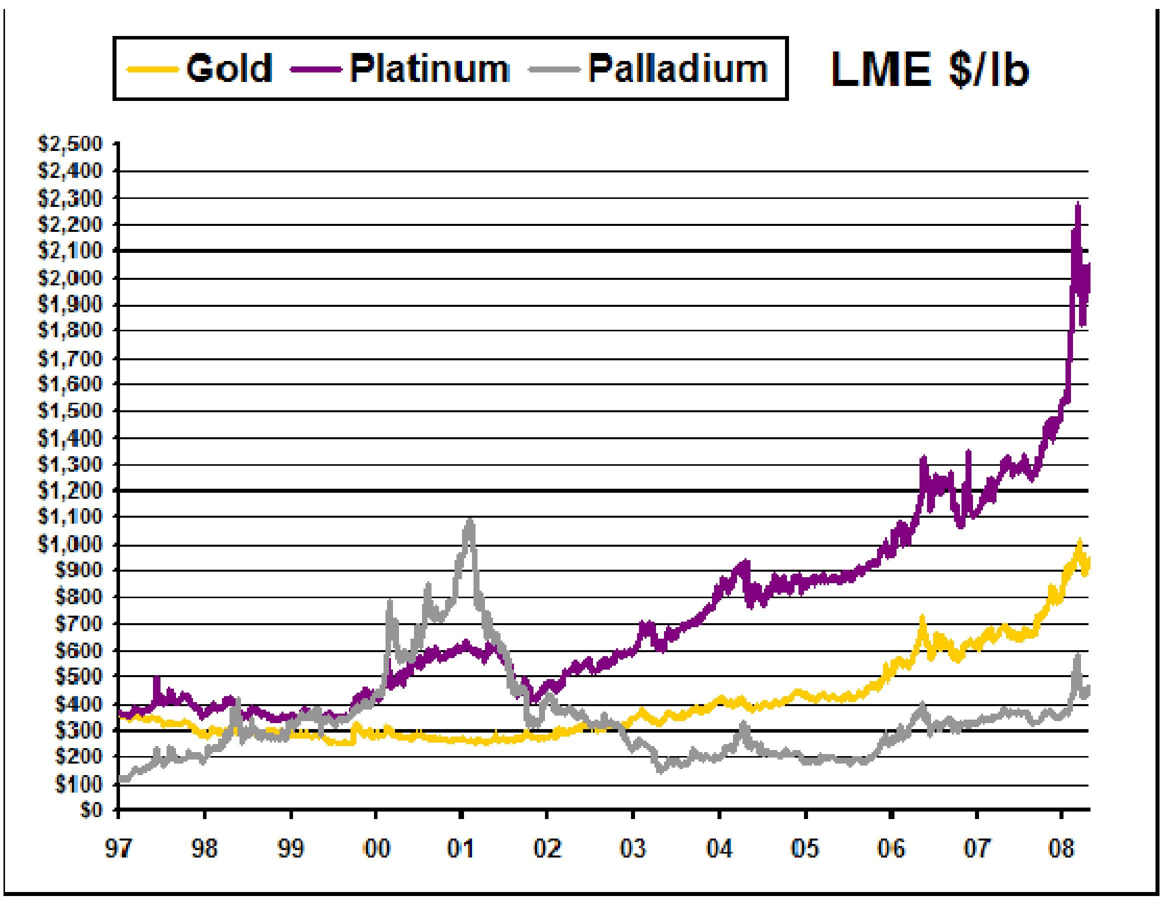




Since 1956 Malpica has been the subject of 7 drill programs totaling 23,000 m of 145 mostly vertical holes. ASARCO held Malpica until 1977 when new foreign ownership restrictions prompted it to abandon Malpica. Aurizon Mines acquired the project in 1988 and optioned it to Cambior in 1994, which conducted a major program in 1995-96 and produced a new resource calculation. Efforts to acquire adjacent ground held by Grupo Mexico failed and Cambior dropped the project. The underlying owners lost the claims in 1998, and in 1999 Grupo Mexico acquired title through a public auction even though the project was well below its minimum size thresholds. Grupo Mexico's interest in Malpica was due to the pet project syndrome, namely where a mining company employee falls in love with a project and works hard within the bureaucracy to keep it alive. Malpica got funding for a regional MMI program designed to identify other potential big targets on the property, funding that was possible because Grupo Mexico is keen on large porphyry systems. However, although copper breccia pipes are related to porphyry systems, any such system present at Malpica is likely to be too deep to be open pit mineable. Malpica's targets never got funding for a drill program, and in 2006 a private Mexican mining and engineering firm, Reyna Mining & Engineering S.A. de C.V., negotiated an acquisition deal with Grupo Mexico. Reyna, which was the source of the polymetallic La Negra project acquired in 2006 by **Aurcana Corp (AUN-V: $0.69)**, a junior with management related to that of Skeena, flipped its Malpica option to Skeena in May 2007 on terms which gave Skeena a one year due diligence option.

Background on Tropico project

The Tropico project was generated in 1996-98 by BHP as part of a regional search for SX/EW amenable copper oxide deposits in Mexico. BHP did not have a budget to follow up the copper-platinum-palladium-nickel values associated with a large mafic intrusive complex that has been traced over 17 km, so it assigned the project to Duane Poliquin's **Almaden Minerals Ltd** in exchange for a 2.25% NSR that has since disappeared when the associated claims lapsed. Almaden, following its prospect-generator-farmout model, optioned 60% of Tropico to Ron Netolitzky's **Santoy Resources Ltd** in June 1999 for a modest $1 million exploration commitment. At the time platinum and palladium were both trading in the $300-$400 per oz range, but by early 2000 palladium had started its Russian supply squeeze orchestrated ascent to its $1,000 per oz peak at the end of 2000. Trenching work by Santoy in 2000 yielded 0.75-1.0 g/t combined platinum-palladium-gold values from pyroxenite within the mafic complex. Copper graded 0.3%-0.5%, which at the $0.75 per lb price in 2000 represented a rock value of only $5-$8 per tonne. The typical 0.2 g/t gold grade at the $300 per oz gold price represented a rock value of only $2 per tonne. But at $600 per oz platinum and $800 per oz palladium the respective 0.3 g/t platinum and 0.5 g/t palladium grades translated into a rock value of $19 per tonne. Tropico was thus a fairly exciting bulk tonnage PGM play for Santoy in 2000-2001.



Although the palladium price had started to fall in 2001, uncertainty about long term supply of palladium and platinum attracted the attention of Sumitomo Metal Mining Company, a fabricator of catalytic converters. Sumitomo optioned up to 70% of Tropico in September 2001 for a commitment to spend at least US $3.5 million and deliver a bankable feasibility study. At this stage Santoy had not yet drilled Tropico, but between November 2001 and January 2003 Santoy conducted 3 drill programs representing 28 holes for 5,024 m on four targets (Maricela, Santa Fe, El Capule and San Pablo). The results were disappointing. The best trench (MT-01-01) had assayed 0.23 g/t platinum, 0.35 g/t palladium, 0.17 g/t gold and 0.53% copper over 160 metres, which at today's metal prices ($958 gold, $2,136 platinum, $552 palladium and $3.75 copper) represents a rock value of $71 per tonne. The best hole in the Maricela target was 110.5 m of 0.14 g/t Pt, 0.24 g/t Pd, 0.09 g/t Au and 0.34% Cu, representing a rock value of $45 per tonne. In terms of the 2000 prices the rock value was $15 per tonne, but by early 2003 palladium had dropped back to $200 per ounce and the rock value of the best hole was only $11 per tonne. In view of a geological assessment that the higher grades in the trenches were due to enrichment of oxidized material, and drill results that indicated weaker grades through thinner horizons than expected, Sumitomo pulled the plug on Tropico and walked away in July 2003 despite having nearly vested for 51%. Although about $4.5 million had been spent on Tropico, with the geologist David Mehner recommending further work to see if the mineralized horizons exist elsewhere on the project, Santoy and Almaden, in light of weak metal prices, shelved Tropico and allowed most of the claims to lapse. The new deal gives Skeena the opportunity to establish a commercial scale new resource.

Conclusion: Skeena Resources Ltd represents a multi-pronged bet on the future of copper prices, the price of platinum and palladium, and the geological ingenuity of Rupert Allan and Ron Netolitzky on behalf of Skeena.

*JK does not own any of the securities mentioned herein