January 28, 2011

Dear clients and colleagues,

The last few years have witnessed spectacular performance for the price of Gold as well as many Gold stocks. In the 10-year period to the end of 2010 the price of Gold went up 422% or 17.94% annually compared to 1.4% for the S&P (all US$). Inflation hedge, reserve currency, and insurance – many arguments are given to justify the rise and predict a bright future for Gold.

To put things in perspective, though, through the end of 2009, a total of 165,000 tones or 5.3 Billion ounces of Gold have been mined in human history. All that Gold would fit in a container of 20.4 cubic meters. Warren Buffet has been quoted as saying that for the value of that Gold at current prices, you could buy all, not some, all of the farmland in the US; you could also buy the 20 largest companies in the US, plus, you would have $1 trillion of walking-around money. Or you could have a big container of metal.

World consumption of Gold produced is about 50% in jewelry, 40% in investments, and 10% in industry. So other than a store of value, the actual uses for Gold are fairly limited.

You may have guessed that we are not big fans of the yellow metal. Being fundamental bottom-up investors, most Gold equities do not meet our fundamental criteria, and that is without talking about the environmental and social impacts of Gold mining.

You may disagree with us. But Gold is 12% of the S&P/TSX, so most Canadian investors will already have a good exposure to Gold.

In the MSCI World Small Cap index, Gold is 1.42% of the index. In addition, precious metals and minerals (platinum, diamonds, etc.) are 0.62% of the index.

We have recently added a precious metals company to the portfolio. The company is Stillwater Mining (SWC US –US$21.78)

www.stillwatermining.com

Business Overview

Stillwater is the largest producer of palladium and platinum in North America. It has two mines in Montana which have the highest grade ore body in the world. The company is vertically integrated and has a smelter and base metal refinery, also in Montana. Finally, it has a growing recycling business and is one of the largest recyclers of vehicle's catalytic converters in the US.

History

Mining in the Stillwater complex began in the late 1800s with chromite and copper nickel. In 1979, Chevron formed a joint venture with Johns Manville called Stillwater PGM Resources. Mining began in 1986. In August 1995, the company started trading publicly on the NYSE. In June 2003 Norilsk Nickel of Russia became a majority stockholder in the company, a stake they sold in December 2010.

The market

The main use (40%) of Palladium and Platinum is for automotive catalysts. Automotive catalysts should experience solid growth from increased auto build and tighter environmental regulations worldwide.

Other industrial usages (electronics, fuel cell, etc.) account for another 20-25%. Jewelry and Investment demand is also growing, following the fundamentals for Gold and Silver. To put in perspective the case for Palladium and Platinum, there are 680 million ounces of silver mined each year, 81 million ounces of Gold and only 7 million ounces of both palladium and platinum.

Competitive advantages

- Long-lived reserve base: 40 years of proven and probable reserves and lots of exploration potential.
- Low-cost assets: Cash cost of production is around $400, around 30 percentile.
- Provides commodity exposure without the geopolitical risks associated with South Africa and Russia, the principal PGM producing countries.
- Vertically integrated.

Growth strategy

- Additional investments in recycling facilities.
- Mine expansions at both Montana mines.
- Acquisition of Marathon PGM Corporation in Northern Ontario.

Management

The 4 top executives have an average tenure of 10 years and own between 5 and 10 years of annual salary in shares.

Market Data

Market Cap U$2.1B, no net debt, cash $260M, fwd p/e (12/2011) 12.3x, fwd ev/ebitda (12/2011) 7.9x

Investment Theme and catalyst

Platinum and Palladium have the same attractiveness as Gold in terms of investment demand. However, there is also an important and growing industrial usage which should make it a lot less volatile. Until recently, Stillwater had two major factors holding back the stock price: a majority shareholder (Norilsk of Russia), which removed the potential for a take-over and limited the float. In addition, a long-term contract with Ford for over 70% of production had a price ceiling. Norilsk sold its holdings in December 2010 and the Ford contract also expired at the end of 2010.

Valuation

Target price = 2 million oz in reserves at $600 profit per oz. = $1200 million, 18 million oz in resources at $100 per oz. = $1800 million. Exploration properties and refining: $500 million. Total US$3.5 Billion = $36 per share.

Have a good week.

Regards,

The Global Alpha Team