

680136 Sheep Creek  
• 82E/3-6  
Giles R. Peatfield, Ph.D., P.Eng.

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23 Sept. 1989

Mr. A.F. Reeve  
904-675 West Hastings St.  
Vancouver, B.C.  
V6B 1N2

Dear Bert:

The enclosed material is a supplement to the information package from Gunsteel Resources, which I understand you have received from Peter Busse, concerning a potential joint venture based on the old Sheep Creek Camp.

While I suspect that there might be a profitable mine on this property, I think it is probably too long term a risk for Blackdome to take on at this time, even if the deal were simple and straightforward, which it is not by any means. Since I have been involved in viewing this on behalf of another client, I would appreciate it if you would confer with Peter and Dave, and respond as you see fit.

Yours very truly,



G.R. Peatfield

GRP/

enclosures

MICHAEL P. GROSS  
Mining Consultant

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Post Office Box 250  
Kingston, Idaho 83839  
Telephone (208) 682-4374

September 12, 1989

Giles R. Peatfield  
Consulting Geologist  
104-325 Howe Street  
Vancouver, B.C. V6C 1Z7

Dear Giles:

The enclosed is for your information. I just finished building a work schedule covering the first 27 months of projected operations in the Sheep Creek Gold Camp. Using the work schedule, I re-did the pro-forma financial statement. I also did a summary of the ore blocks that would be mined and applied additional conservatism.

I have included copies of all three documents, plus pro-formas for the first two years which are broken down on a monthly basis.

Since the same conservatism that was built into the first proforma was also included in this one a copy of a memo explaining the conservatism is inclosed for your reference.

If I can answer any questions please call me at (604) 357-9343.

Sincerely yours,

  
Michael P. Gross

Enclosures:



FROM THE SILVER VALLEY IN THE COEUR D'ALENE MINING DISTRICT OF NORTH IDAHO

GUNSTEEL RESOURCES INC.

September 12, 1989

Memorandum To: Stan A. Endersby  
Gary Allen

From: Michael P. Gross

Subject: Conservatism Built Into Pro-Forma Financial Statement

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I'm concerned that we are not getting the attention focused on the Sheep Creek project that it deserves. Apparently I have built so much conservatism into my numbers that any additional conservatism added by a potential partner kills the project as far as they are concerned. I believe that when one understands both the geology and the existing mines, the project stands on its own merits. From experience, I know that a project like this can become a very profitable operation.

A question I anticipate a potential partner asking is, "If this is so good, why hasn't someone else discovered it sooner?" My answer is that current economics require that old mining camps like Sheep Creek be consolidated or unitized in order to offer a return on investment that's attractive to operating mining companies. Also, someone knowledgeable about narrow vein underground mining has to develop the cost and operating plans, which is where I come in.

Gunsteel has already completed the hardest part by getting agreements to unitize the camp and obtaining a mill to process the ore. The easy part is starting up production. Start up capital of \$2,000,000 will generate a profitable mining operation.

To help you or a potential partner understand the conservatism already built into the project numbers, the following explanation is provided for your reference.

1. A 25% success factor was used for finding ore in favorable rock types. This compares with the following success rates actually experienced in the camp:
  - 1.1 Reno Mine 38%
  - 1.2 Combined Reno-Nugget-Motherlode Mine 27%
  - 1.3 Goldbelt Mine 34%
  - 1.4 Kootenay Belle Mine +50% (file memo)
  - 1.5 Queen Vein +50% (file memo)
  - 1.6 81 Vein +35%
2. The amount of development drifting required to achieve 25% success was increased by 25%.
3. The amount of knuckle raising required to block out ore at a 25% success rate was increased +35%.

4. Development drifting costs include an additional 20% to cover development work than does not find ore.
5. Extra manpower was added to all direct costs to insure that labor costs are realistic.
6. The rate of drift development and knuckle raise advance was increased a year before production increases occurred. This was done for two reasons:
  - 6.1 To insure that mill throughput would remain at the increased tonnage once it was reached.
  - 6.2 To insure that adequate ore reserves were developed.
7. Estimated operating costs are built from the ground up. Labor costs are based on productivity and competitive wage rates. Consumable costs are based on miner productivity and quoted prices.

Following next are summaries of three concepts that are important to understand and remember when evaluating the Camp and its potential.

1. Gold bearing quartz veins are normally 1000 feet long and vary from two to eight feet wide. Some veins have over 2000 feet of continuous gold bearing quartz veining.
2. Within favorable host rocks, ore grade gold mineralization can occur over a vertical distance of 1600 feet. (This 1600 foot limit may have been controlled more by economics than by mineral deposition.)
3. Single ore shoots have been mined over vertical distances greater than 800 feet and horizontal distances greater than 400 feet. Ore shoots usually extend 200 feet horizontally and 400 feet vertically. An ore shoot of this dimension would contain about 24,000 tons of ore, which, @ .4 oz Au per ton, contains more than \$4,000,000 in gross metal value.

Initial mining is planned for developed and semi-developed reserves already blocked out in existing workings. These reserves are adequate for two plus years of production. In addition, recent work indicates more than 10,000 tons of dump material is available on the consolidated properties. These dumps will average .15 oz Au per ton and only need to be loaded and hauled to the mill for processing.

On the western anticline and the recumbent limb of the eastern anticline there is a combined strike length of 20,000 feet of unexplored ground that may host as many as 40 new veins. In addition, the upturned limb of the eastern anticline contains another 20,000 feet of unexplored ground that may well host another 30 to 40 ore bearing veins.

In reviewing the literature, I came across a 1941 CIM paper that contains production and cost data for the four companies then operating in the camp.

Production:

1. Total designed production capacity of the four cyanide vat leach mills was 670 tons per day.
2. The mills were probably operating seven days per week because the actual tons milled would have required operating at 140% of design capacity.
3. Average Au recovery was +97.5%.
4. The weighted average cost per ton milled was \$1.53.
5. Based on a five day week, total mine production in the camp averaged over 850 tons per day.

Costs:

1. The weighted average total cost from all four operations (mining, milling and overhead) was \$7.39 per ton milled.
2. The average mining cost to development cost ratio was 1.8.

Using my pro-forma statement for production increasing from 150 to 500 tons per day, the mining cost to development cost ratio is 1.24. This represents a development cost 45% higher than the old timers needed to develop reserves adequate to mine a combined total of more than 850 tons per day. This comparison supports the conservatism that was built into development costs in the pro-forma financial statements.

My base cost estimate for mining, milling and property overhead, including 10% contingency, but without any capital or rehabilitation costs, is \$90.00 per ton. A cost of \$90.00 per ton represents a 1219% increase over costs actually incurred. This increase equates to an inflation rate of 24.39% per year for 50 years. Inflation in the U.S. actually averaged 16.8% per year for those 50 years. Based on a cost of \$7.39 per ton, the following costs were calculated using an inflation rate of 24.39% per year:

1. 1950 - Costs are \$18.02 per ton
2. 1960 - Costs are \$36.03 per ton
3. 1970 - Costs are \$54.05 per ton
4. 1980 - Costs are \$72.07 per ton
5. 1990 - Costs are \$90.00 per ton

The following costs for deep underground mines having significant ground support costs, which is not required in the Sheep Creek camp, are presented for comparison purposes:

1. 1980 - Homestake Mine, about \$50.00 per ton
2. 1980 - Lucky Friday Mine, about \$75.00 per ton
3. 1982 - Star Mine, about \$54.00 per ton

These cost comparisons further support the cost estimate that basic mining, milling and property overhead will not be more than \$90.00 per ton. I believe that after the first year of operation, actual costs will be closer to \$60.00 per ton than \$90.00 per ton .


Based on the pro-forma financial statements for a grade of .4 oz Au per ton, in year two of the project, total cost per ounce produced, including capital and rehab costs, is as follows:

- 1. Canadian \$328 per oz Au
- 2. U.S. \$262 per oz Au

In year seven of the project, total cost per ounce produced, including capital costs, is as follows:

- 1. Canadian \$230 per oz Au
- 2. U.S. \$184 per oz Au

After reviewing the enclosed material please give me a call if you have other questions.

  
Michael P. Gross

GUNSTEEL RESOURCES INC.

September 10, 1989

**Tonnage That Will Be Developed Or Mined  
Per The  
Gantt Chart Showing Workplace Schedules**

The following tabulation shows tons of ore converted to the developed and semi-developed category during the first 27 months of project operations. Some of the tonnage will be from reserves now classified as proven, probable or possible category. The rest of the tonnage will be from reserves now classified as geologic or inferred reserves.

As explained elsewhere in the promotional package, significant conservatism has been included in the work schedules and ore development plans. The following tabulation includes all those conservative factors in the column labeled "Tons". The column labeled "Reduced Tons" uses the preceding "Adjustment Factor" to add even more conservatism to the tons developed.

Total reduced tons converted to the developed category exceed the tons mined from the developed category by 70%. This substantiates the argument that adequate tonnage can continue to be developed that will maintain mill feed at projected levels.

<u>Location</u>	<u>Tons</u>	<u>Adjustment Factor</u>	<u>Reduced Tons</u>	<u>Date</u>
Drift 6600V - Dixie Level	16,734	75%	12,551	6/4/90
Rse 6600-1 - 2100 Goldbelt	14,583	50%	7,292	4/5/90
Rse 8000-1 - 2100 Goldbelt	3,675	75%	2,756	6/1/90
Rse 8000-2 - 2100 Goldbelt	1,033	75%	774	6/1/90
Stope 1 Level - Reno	6,000	75%	4,500	7/23/90
Stope 5 Level - Reno	11,600	50%	5,800	9/1/90
Rse 8200-1 - 2100 Goldbelt	3,892	75%	2,919	7/3/90
Rse 8200-2 - 1975 Goldbelt	2,745	75%	2,058	7/3/90
Rse 2360-1 - 1850 Goldbelt	11,666	50%	5,833	10/1/90
Rse 2360-2 - 1600 Goldbelt	5,833	75%	4,375	10/1/90
Rse 3040-1 - 1850 Goldbelt	8,750	50%	4,375	12/1/90
Rse 3040-2 - 1850 Goldbelt	11,666	50%	5,833	12/1/90
Drift 8000V - So - Eastern	29,531	75%	22,148	1/29/91
Rse 8000-4 - 1850 Goldbelt	8,750	50%	4,375	3/4/91
Rse 8000-5 - 1850 Goldbelt	8,750	50%	4,375	3/4/91
Rse 8200-4 - 1850 Goldbelt	8,750	50%	4,375	5/21/91
Rse 8200-5 - 1850 Goldbelt	15,166	50%	7,583	4/2/91
Rse 8000-6 - 2100 Goldbelt	1,442	75%	1,081	5/7/91
Rse 8000-7 - 1975 Goldbelt	4,667	50%	2,333	5/28/91
Rse 8000-8 - 1975 Goldbelt	2,916	50%	1,458	6/24/91
Drift 3500 - 1850 Goldbelt	20,052	75%	15,039	5/9/91
Rse 8200-6 - 1975 Goldbelt	963	75%	722	6/26/91
Rse 8200-7 - 1975 Goldbelt	1,006	75%	754	7/27/91
Rse 8200 8 - 2100 Goldbelt	6,562	75%	4,922	8/29/91
Drift 8200V - Eastern Anti	29,531	75%	22,148	9/26/91

Rse 4L1 - Reno Mine	2,187	50%	1,093	10/31/91
Rse 3L1 - Reno Mine	5,833	50%	2,917	10/31/91
Drift & Rse's - Fawn Vein	29,875	75%	22,406	11/7/91
Rse 2360-3 - 1850 Goldbelt	5,250	75%	3,937	11/15/91
Rse 2360-4 - 1850 Goldbelt	14,583	50%	7,292	11/30/91
Rse 2360-5 - 1600 Goldbelt	8,750	50%	4,375	12/15/91
Rse 2360-6 - 1400 Goldbelt	11,667	50%	5,833	12/31/91
Rse 3040-6 - 1400 Goldbelt	11,666	75%	8,750	12/31/91
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<b>Totals</b>	<b>326,074</b>		<b>206,982</b>	

<b>Total tons mined &amp; milled during first 27 months =</b>	<b>113,300</b>
<b><u>Total ounces produced during first 27 months =</u></b>	<b><u>36,267</u></b>
<b>Total "reduced tons" converted to developed and semi-developed during first 27 months =</b>	<b>206,982</b>
<b>Developed &amp; semi-developed tons exceed tons milled by 82%</b>	
<b>At start of project developed &amp; semi-developed tons =</b>	<b>90,000</b>
<b>Tons milled in first 27 months =</b>	<b>-113,300</b>
<b>Tons added to developed &amp; semi-developed category =</b>	<b><u>206,982</u></b>
<b>Developed &amp; Semi-Developed Tons Remaining After 27 Months =</b>	<b>183,682</b>
<b><u>Total Developed &amp; Semi-Dev. Ounces Remaining After 27 Months =</u></b>	<b><u>64,289</u></b>

#### Production Schedule Per The Gantt Chart

Production Starts:  
December 1, 1989 @ 100 T/D

Production Increases On:  
April 1, 1990 150 T/D  
June 1, 1990 200 T/D  
October 1, 1990 250 T/D  
June 1, 1991 300 T/D  
June 1, 1992 500 T/D

mpg: