

Company Report

CONTINENTAL GOLD CORP. (CNTVF/OTC \$11 3/4 - 5/11/90)

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SUMMARY

- Continental is a junior Canadian gold exploration company. Its shares are traded on the Vancouver Stock Exchange in Canada and on NASDAQ in the U.S. The company has applied for a Toronto Stock Exchange listing as well. In 1986 its partially owned subsidiary (69%), United Lincoln Resources, optioned a 69.84% interest in the then-unexplored Mt. Milligan property from BP Resources Canada Ltd.
- As a result of an extensive \$11.7 million exploration program managed by Continental, a massive gold/copper ore deposit has been delineated at Mt. Milligan. Over 600,000 feet of diamond core drilling has proven some 440 million tons of ore containing 6.4 million ounces of gold and 1.8 billion pounds of copper. In their present delineated but undeveloped state, these ore reserves have a value of over \$400 million, or \$285 for Continental's 70% interest. This equates to \$36 per Continental share.
- Management and directors own about 35% of the shares, Rio Algom (RTZ) owns 9% and Hemlo Gold owns 4%.
- In October 1989 BP Resources filed a writ in the Supreme Court of British Columbia alleging that Continental breached BP's right of first refusal to buy the joint-venture mining claims when, on March 15, 1989, Continental amalgamated with its subsidiary, United Lincoln, which held the mineral claims to Mt. Milligan. Counsel to Continental has advised that BP's claim lacks merit, and Continental is claiming damages arising from BP's suit.
- Until the Continental/BP issue is resolved (a trial date is set for November 5), we do not expect the stock to reflect the full value of the company's assets. However, given the countersuit by Continental and the presence of Rio Algom (controlled by RTZ, PLC, the world's largest mining company), which has significant cash reserves and an appetite for gold mining, we believe an out-of-court settlement could be reached before November's court date. Thus, we believe investors who can tolerate the high risk associated with Continental should establish holdings before the suit is resolved or Continental is acquired by another mining company.

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Oppenheimer & Co., Inc.

CONTINENTAL GOLD CORP. (CNTVF/OTC \$11 3/4 - 5/11/90) Jordan Estrera
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12-Month Range	\$11 3/4-\$4	Dividend	Nil
1988 EPS	\$(0.10)	Yield	Nil
1989 EPS	\$(0.19)	Price/EPS 1988	NM
1990 Est. EPS	Loss	Price/Est. EPS 1989	NM
1991 Est. EPS	Loss	Price/Est. EPS 1990	NM

Capitalization (12/31/89)

	<u>Million</u>	<u>Percent</u>		<u>Million</u>
Long-term Debt	\$ 0.0	0%	Current Assets	\$1.1
Equity	<u>14.9</u>	<u>100%</u>	Current Liabilities	<u>0.4</u>
			Working Capital	<u>\$0.7</u>
				i
Total	\$14.9	100%	Current Ratio	2.8:1

Shares Outstanding	7.9 Million
Float	5.5 Million Shares
Market Capitalization	\$93 Million (U.S.)
Recent Average Daily Trading Volume	40,000 Shares
Fiscal Year Ends	December 31
Book Value/Share (12/31/89)	\$1.89
ROE (1990E)	NM

Estimated 1990 P/E Relative to S&P Inds. P/E	NM
5-Year Historic Relative P/E Range	NM
S&P Industrials	400.21

Other Securities: none.
Oppenheimer & Co., Inc. makes a market in this security.

INVESTMENT OPINION

Continental Gold holds several mineral interests in Canada. One of these is a 70% interest in the Mt. Milligan deposit in central British Columbia worth approximately \$36 per share. We believe management has explored finding an acquirer for the company, but its efforts in that regard are now impeded by a suit filed by BP Resources, its 30% partner. We believe the suit is without merit. However, if BP prevails, it would likely have to acquire Continental's holding in Mt. Milligan for fair value, which we believe is \$36 per Continental share but, in any event, is likely to be well more than the present market price of Continental (\$11 3/4 per share).

However the suit is resolved, we believe shareholders will reap significant capital gains in 1990 or 1991 from the ownership of Continental Gold. Members of management, who are the largest shareholder group, are seeking to maximize value in the shortest possible time. We believe there are several likely suitors for Continental, including its largest non-management shareholder, Rio Algom Corp. (ROM/ASE \$16 7/8). In our opinion, at some point during the next 12 months someone will pay well in excess of Continental's current price to gain control of the Mt. Milligan ore deposit. Investors who desire significant gains but have a tolerance for risk could well profit from an investment in Continental Gold.

MT. MILLIGAN PROJECT

The Mt. Milligan deposit is in central British Columbia, Canada, approximately 100 miles north of Prince George, a logging, sawmill and pulp mill community of 70,000 inhabitants. Electrical power and rail transportation are already available in proximity to the deposit. In addition, many major open-pit copper mines already operate in the vicinity of Mt. Milligan, although several will be depleted in the next few years, thereby freeing a labor force with mining skills already trained for this project.

In 1984, BP Resources Canada Ltd. acquired the Mt. Milligan property. After completing surface surveys and preliminary evaluations, BP optioned 69.84% of the property to United Lincoln Resources, a partially owned subsidiary of Continental. United Lincoln is the project operator and managed the \$11.7 million exploration program that delineated the ore body. A \$7.1 million engineering and economic feasibility study, to be completed in 1990, will provide the basis for the financing and development of the project.

The project encompasses a ten-square-kilometer area in which two adjacent major sulfide ore systems have been discovered: Mt. Milligan and Southern Star. Over 600 diamond core drill holes have been made over a total distance of 600,000 feet (more than 100 miles of ore sampling). This drilling has proven an ore deposit of 440 million tons, which contains 6.4 million ounces of gold and 1.8 billion pounds of copper. The deposits are relatively shallow, underlying an overburden averaging some 75 feet thick. The ore deposits are flat and up to 850 feet thick. They are each about 4,000 feet long and about 2,000 feet wide. Preliminary engineering estimates suggest a very low 1.2:1 stripping ratio.

Extensive metallurgical testing has been conducted by Lakewood Research Labs in Toronto. A conventional crushing, grinding and mineral oils flotation

circuit is expected to recover a concentrate of copper and gold. A 90% recovery rate is expected for each mineral. The concentrate will be shipped for processing, probably to Japan, with the Mt. Milligan project being paid for the contained metals, less standard smelting and refining charges. The lack of an on-site smelter or the use of a cyanide gold recovery process will no doubt speed up the environmental permitting process, which should be completed this year.

The present scope of the project, which will be refined by the final feasibility study, calls for a 60,000 ton per day milling operation (approximately 72,000 tons per day of mining), which will produce 440,000 ounces of gold and 83 million pounds of copper per year for 15 years or more. Assuming copper at \$1.00 per pound, the production cost for gold is only \$40 per ounce. Capital costs will approximate \$300 million.

The value of recovered minerals in every ton of ore processed would approximate \$9, while operating costs would be only about \$5 per ton. The \$4 operating margin on almost 20 million tons per year means operating cash flows, before financing and taxation, of \$80 million per year on a project basis, or over \$55 million or \$7 per share for the account of Continental.

VALUATION OF MT. MILLIGAN

Mt. Milligan is a well-drilled and proven ore deposit. However, environmental permits and a mining license have not yet been issued. Final engineering and economic feasibility studies will be completed this year, at an additional cost to the project of some \$7 million. Still, we believe this ore deposit, which is one of the largest ever discovered in Canada and which will support one of the major mining operations in the world when developed, would have substantial value to major mining companies that are trying to expand their reserves and production of gold and copper.

Specifically, we believe that reserves on the scale of those at Mt. Milligan are worth some \$50 per ounce of gold and \$0.05 per pound of copper in the ground. It should be noted that present market prices of large-scale gold produces values for gold reserves between \$150 and \$200 per ounce, and Minorco recently acquired Freeport Gold for \$285 per proven ounce of gold.

As shown in Table I below, we value the Mt. Milligan project at just over \$400 million, or \$285 million for Continental's 70% interest, which is equal to \$36 per Continental common share.

Table I

Continental Gold Corp.
Valuation of Mt. Milligan
(\$ Mil. U.S.)

	<u>\$ Mil.</u>
1. Value as a Proven, But Undeveloped, Ore Deposit	
Value of In-Situ Reserves	
Gold @ \$50 per Ounce, 6.45 Million Ounces	\$317.5
Copper @ \$0.05 per Pound, 1.8 Billion Pounds	<u>90.0</u>
Total	\$407.5
Continental's 70% Interest	\$285
Per Continental Common Share	\$ 36
2. Present Value of Future Production	
Gold: a. \$2,500 per Ounce of Annual Production 440,000 x \$2,500	\$1,100
b. \$150 per Ounce of Operating Reserves 6,350,000 x \$150	\$ 950
Average of a. and b.	\$1,025
Copper Production at \$2.00 per Pound 83,000,000 x \$2	<u>\$ 166</u>
Total Value of Production	\$1,191
Less: Development Capital	<u>300</u>
	\$ 891
Continental's 70% Interest	\$ 624
Per Continental Common Share	\$ 80

CONTINENTAL'S STRATEGY AND TAKEOVER POSSIBILITIES

The two key executives of Continental are Robert Hunter, chairman and chief executive, and Robert Dickinson, president and chief financial officer. Each owns approximately 11% of the common shares. Other major shareholders include Rio Algom, the Canadian-based subsidiary of mining giant RTZ, PLC (9%) and Hemlo Gold (4%). Continental has had discussions with several major North American mining companies exploring joint ventures and possibly the sale of Continental. Management believes that Continental would have difficulty financing its share of a \$300 million construction project. The potential for dilution of existing shareholder interests (remember that management is the largest shareholder group) combined with the time and risk exposure related to normal engineering and metals market risks, as well as environmental and other

risks associated with mining, suggest that a sale now could result in greater value realization for shareholders.

Our valuation suggests this is sound logic. We estimate the value of Mt. Milligan at \$36 per Continental share as an undeveloped ore deposit. Developed we believe it is worth \$80, but we would apply a 20% per year discount for the three to four years necessary to complete engineering and construction and to put the mine into production. Therefore, even without dilution to existing shareholders caused by the raising of new equity, the discounted value of Continental's shares once Mt. Milligan is in production would be on the order of \$40. However, if Continental were to proceed with the development of Mt. Milligan, additional equity would almost certainly have to be raised; therefore, we believe management would maximize shareholder values by seeking to sell now.

THE BP LAWSUIT

At the time United Lincoln Resources, then a partially owned subsidiary of Continental, obtained the option from BP Canada Resources, a standard right-of-first-refusal clause was put into the joint-venture agreement between BP and United Lincoln. The right of first refusal was to protect each partner from finding itself with a new, and potentially unwanted, partner in the event one of the partners was acquired or wanted to sell its ownership interest in the project to another company.

In March 1989, after operating the joint venture through United Lincoln, Continental decided to amalgamate with United Lincoln by exchanging shares of Continental for the publicly held shares of United Lincoln. BP was notified some six weeks prior to the amalgamation, and informal discussions took place between Continental officials and those from BP. The result of these discussions was that BP had no objection, and indeed no right, to interfere with the restructuring of Continental/United Lincoln. Six months following the amalgamation, in October 1989, BP filed a writ in the Supreme Court of British Columbia claiming that its right of first refusal had been breached by the Continental/United Lincoln amalgamation.

Continental counsel believes the writ is without merit, and we do as well. However, even if BP prevails, it would be able, at best, to acquire Continental's 70% claim in the Mt. Milligan ore deposit for the value received by United Lincoln shareholders. More than likely, the court would place a "fair value" on the assets, which could then be acquired by BP. We cannot help but believe the Canadian Foreign Investment Review Board might prevent a British corporate giant from stealing an undeveloped ore body from a junior Canadian gold company, especially when the British giant owned it all originally but did not have enough faith in the discovery to continue to work on it. Only after the deposit had been proven to be one of the largest ever made in Canada did BP show renewed interest, and then only after it had had considerable time to object to the Continental/Lincoln Resources amalgamation in the first place.

Continental has filed a countersuit seeking damages related to the loss of a \$15 million line of credit as well as damages related to the breakoff of discussions with one major mining company regarding the acquisition of Continental. Rio Algom, Continental's largest outside shareholder, and a company that has significant cash on hand and an unsatisfied appetite for copper and

gold mining, might well hold one of the keys that enables resolution of this issue before the scheduled court date in November 1990.

We believe it highly unlikely that a Canadian court would take away a major ore discovery from a junior Canadian company without providing the company fair compensation for the loss of its assets. We believe such compensation would be on the order of the \$36 per share at which we value Continental's 70% interest in Mt. Milligan. Therefore, we believe the potential reward from owning Continental Gold more than outweighs the risks.

RISKS

All gold mining companies present investors with greater than usual risk due to the leveraged linkage of the share price to the gold price and the high degree of volatility associated with gold pricing. Continental subjects investors to added risks.

As a junior company with no operations and no income, the entire value of Continental rests on its undeveloped ore bodies. Whether these will be developed is unknown, and if developed the timing, capital and operating costs are presently unknown. Furthermore, the ownership rights to Continental's major property, Mt. Milligan, are being disputed.

Investors should be aware of these unusual risks. While we believe the potential returns justify the risks, we do not believe these shares are suited for all investors. Those with portfolios that can tolerate this risk could well enjoy exceptional returns.