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Warren Irwin Favors Extensive, Aggressive Drilling

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Whether it's precious or base metals in the ground, Rosseau Asset Management founder Warren Irwin likes to see extensive, aggressive drill programs in promising deposits. In this exclusive interview with The Gold Report, he says that investments in such companies have paid off in the past and are likely to do so in the future. Gold or silver, copper or nickel, even if commodity prices fall, he argues that the miners with the higher-grade deposits and busy drills have—and offer—the best price protection.

The Gold Report: Opinions go both ways—whether people should be buying or selling gold, for instance. Copper is picking up and going strong, so some folks say it's time to get back into base metals. Would you share your overview of the precious and base metals markets today? Where do you see the opportunities?

Warren Irwin: I've been investing in these sectors for years and one thing I try to avoid is a view on the commodity itself. I try to invest in the companies within a sector that have tremendous upside potential, whether the commodity goes up or not. If the commodity declines in value, extensive drill programs will help offset that decline. This approach has worked really well for us.

A couple of interesting things are going on with respect to both base metals and gold. Central banks have informal agreements to keep a lid on the gold price because its rapid appreciation would undermine the strength of the fiat currency system. Longer term, despite that downward pressure, there seems to be demand on the buy side and gold's fundamentals are pretty good. In the meantime, we just try to pick the best among miners that are finding gold every day as they sink drills into their properties.

On base metals, copper in particular has had a reasonable run the last little while. Much of that is due to countries like China stepping up to the plate and investing money in copper they'd otherwise invest in U.S. dollars. I'm sure the amount of copper the Chinese are buying is well in excess of their demand, but over the longer term they believe it's a good place to keep their money. That's been very bullish for copper.

TGR: If they're buying more copper than they need, won't copper fall once they stop buying? It will take years for them to work through the inventory they've accumulated.

WI: That may be the case. I think they view copper as a strategic metal. They are building out their electrical infrastructure, so they're going to be using a lot of it over the coming years. But you're right. It certainly would be something to keep an eye on when they start backing off buying copper.

TGR: When you talk about gold, are you also thinking of the precious metals—silver, platinum and palladium?

WI: When I look at precious metals, I generally focus on gold and silver. The reason I don't consider platinum and palladium precious metals is due to the industrial demand for them. The correlation between platinum-palladium prices to automotive sales is strong. So in terms of precious metals, I stick more to silver and gold. Even with silver and gold, the relationships between those two commodities can be quite volatile.

We've had substantial silver positions in the past and we really liked some of the companies that had good silver deposits, for example, Aquiline Resources Inc. (TSX:AQI). At one point, we were one of their largest shareholders and were very positive on their Navidad deposit in Argentina. Over time, we did not like how the company was managed and sold our entire position, but I'm definitely quite positive on gold and silver, long term. I think buying good companies in those businesses is a smart thing to do.

TGR: Are you thinking of near-term producers or more of drill plays?

WI: I'm a real fan of drill plays. I'm not a fan of near-term producers because, as I suggested, we've really benefited when we've been able to buy into a company with maybe a half a million ounces that's on its way to one to two million ounces. That way, if the price of gold stays where it is, that's great. If it goes up, that's better. But if the price drops from, let's say, $875 an ounce down to $700, the fact that this company is drilling out resources from half a million to one to two million—that increase in resources will offset a substantial amount of the decline in the gold price. For that reason, we generally stay with higher-grade deposits because they offer the best price protection.

TGR: When you say "long term," what's your timeline?

WI: I think it's just a matter of time before the printing of U.S. dollars has a massive inflationary impact on the world. And I think gold will be a very strong performer once people figure that out. People will tire of earning virtually nothing in their money market accounts. As they gradually start seeing the impact from the U.S. government printing a substantial amount of dollars, they will realize they are losing purchasing power. At that stage, they will see gold as one of the better-performing investments.

TGR: You say the U.S. government, but aren't all governments trying to print their way out of this economic morass?

WI: Not all of them, and not to the same extent as the U.S. The U.S. is really the poster child for printing currency. Another important factor, too, is that because gold is dollar-denominated, its performance in U.S. dollar terms would be very good. That's why I focus more on the U.S. dollar than other currencies.

TGR: Geithner says he's just going to increase interest rates to control inflation in the future and just pull out some of the M1s. If we're looking at gold as a hedge against an inflationary U.S. dollar, and you listen to Geithner, what's to say gold's really going to take off and they can't continue to manipulate it for another 10 years?

WI: We'll see what happens. History is rife with examples of currencies that have not fared well. I was on

a website the other day looking at 500 failed fiat currencies, and it was surprising what a short lifespan these paper currencies had. You don't have to go very far back to see the number of industrial countries that printed their way into some serious problems. The most recent major industrial country to do so was Germany in the early part of the last century. I have serious concerns about that. If they were taking bets on whether Geithner would be right or I would be right, I think many would bet on me.

TGR: That same article said an average fiat currency had a life expectancy of around 100 years. That argues for increasing value for precious metals, gold and silver. What drives base metals? And which ones do you like?

WI: Base metals have been bouncing around. They got a bit carried away for a while when you had nickel north of $20 and now it's down below the cost of production in major mining camps, such as Sudbury. I don't think there's much downside from here. The prices of some of these base metals have muddled along here for a while and, in that muddling along kind of environment, the best ones to invest in are companies that are able to increase their resources through an extensive and aggressive drill program. I'm always on the lookout for new discoveries—I like looking at new copper and nickel discoveries.

TGR: Not that you necessarily invest in them, but who are the largest publicly traded producers of copper and nickel? What are a couple of the big names that our readers might know?

WI: Big names in nickel would be Norilsk Nickel (Nasdaq:NILSY) (LSE:MNOD), Xstrata PLC (LSE:XTA) and Vale (NYSE:RIO), which recently bought out Inco Ltd. On the copper side, one of the major producers I like is Freeport-McMoRan Copper & Gold Inc. (NYSE:FCX), which is a tremendous copper producer on the big cap side. One of the reasons I like them is their gold exposure. Freeport has upwards of 50 million ounces of gold in situ, along with the copper in their Grasberg deposit in West Papua, Indonesia.

TGR: Freeport just had a nice little move off the December lows. They were trading around $16 and today up to about $49.

WI: It definitely has had a good run. It's a benchmark that lot of people look to when they go after copper.

TGR: What smaller companies do you currently own and like in the gold area?

WI: Getting back to my theme of good-quality juniors that are expanding their resources, some of the names I like on the gold side are Osisko Mining Corp. (TSX:OSK), Queenston Mining Inc. (TSX:QMI) and Colossus Minerals Inc. (TSX:CSI) . They all have some pretty nice stories. I think Osisko is just a great story. I saw the property last fall and just to give you a sense of the lack of excitement about it then, I was the only person on the tour. I really liked what I saw, though—a tremendous deposit in Quebec, which is the best mining jurisdiction in the world. I saw low power costs, access to excellent infrastructure, highly skilled workers readily available locally and a very large, relatively low-grade deposit that I think could be mined very effectively.

When I bought in, Osisko was a bit constrained. A lot of people thought it would be unable to raise the capital to put its property into production. Since then, things have improved and Osisko has raised a lot of money. Once they have their warrants exercised, there's a very good chance they will have all the cash they

need to go into production.

The reason I believe Osisko is a good choice from this point forward, despite recent price appreciation, is that it has a 10+ million ounce deposit. It's the type of deposit that majors like and as I mentioned, it's in a tremendous jurisdiction with a lot of cost advantages. Interestingly, within those 10+ million ounces, there appears to be about a 7-million-ounce, relatively high-grade core of between 1.75 and 1.8 grams. Even if the price of gold backs off a little, they're still in a pretty good position to move this project forward.

I think the majors are definitely looking very, very hard at Osisko, the amount of resources they have and the amount of production that can be achieved from that. They are well on their way to moving it forward with an excellent development team.

TGR: What sort of timeline are we looking at, assuming the warrants get exercised?

WI: I believe they'd be looking at nameplate, or full capacity around April 2011 and their first full year of production in 2012. As they move forward with production, they're also expanding their resource base, which makes this a more exciting story every day. They found a new zone called the Barnat Zone that's looking very good. It's adding a lot of higher-grade material to their resources, which is one of the kickers I really like about it.

TGR: What about the others, Queenston and Colossus?

WI: Again, I like companies in great jurisdictions, and Queenston Mining is in a tremendous situation. It's the dominant landholder in Kirkland Lake, which is the second-largest mining camp in Canada. In historical terms, about 40 million ounces have been produced from that area. Charlie Page runs the company. He's a hard-working and honest mining professional. It's conservatively run and all cashed up. I really like the aggressive drill program going on there, which will help build on Queenston's 2 million ounces of reserves.

They're in joint venture on some property with Kirkland Lake Gold Inc. (TSX:KGI) , the other major gold company in the area, and they're seeing tremendous success on their drilling. If you follow the trend, there's a very good chance some of these very good results will continue on to Queenston's 100%-owned property. Their Upper Beaver Zone is also kicking in a bit and getting some good results. From an investor base, some solid and very experienced investors are backing Queenston; and they know some of the upside that could be available over the next number of years as they continue to build ounces.

TGR: What sort of catalyst will drive this stock? Further expansion of the resource?

WI: Near term, I believe it will be their drill program. They'll add ounces over time, which builds value for shareholders every day. Longer term, it's pretty obvious something will happen on the M&A front. If Queenston is able to build resources to the point where it is a standalone operation, it would be a target for a major interested in a high-grade gold mine in one of the best mining camps in the country. Also, it seems pretty obvious to me Kirkland Lake Gold and Queenston should merge at some point. I could see that transaction happening over the next few years as both realize the benefits of teaming up. Kirkland Lake already has production and Queenston seems to have a lot of the land position in the camp and some tremendous blue sky. The two companies together would make a great mining company.

TGR: What about Colossus?

WI: Colossus Minerals is one of my favorites for a number of reasons. Again, the jurisdiction is one I like—it's in Brazil, a mining-friendly country. But what's interesting about Colossus is its very, very rich property. The grades are unlike anything I've seen in my career. And because of the tremendous grades, in terms of gold and some of the other precious metals—platinum and palladium—they're able to achieve a substantial amount of ounces of precious metals in a very small plot of land.

In my opinion, Colossus will get to 3 million ounces of gold and with byproduct credits, such as platinum and palladium, that gold can be mined at a negative cost and over a short period of time. That's extraordinarily lucrative and attractive for a major mining company to step in and mine this ore.

Right now, the company is extremely cheap and definitely on the majors' radar screens. The risk I see going forward is Colossus' ability to handle its relationship with partners. Its partner is a company called COOMIGASP (Cooperativa de Mineração dos Garimpeiros de Serra Pelada), an organization of the Garimpeiros who once mined the deposit in a large open pit. They're teamed up with Colossus to work on mining the underground portion of this deposit. It's frankly an extremely exciting deposit, probably richer than anything else I've ever seen. It has a negative cost of production and could be mined very quickly. It's like having almost $3 billion worth of metal just sitting there ready for you to take it out. I think it's extremely cheap and I imagine a number of majors see the same benefit, too.

TGR: It's a large lake, right?

WI: That's right; the old open pit has filled in with water. What Colossus has is the down-dip extension of that high-grade material found in the pit.

TGR: What would it take for Colossus to go into production?

WI: It would not be very difficult. It's very shallow and, again, very concentrated. All these millions of ounces are in a very small area. It would require some underground expertise, which the local COOMIGASP does not have, which is why they brought in Colossus. But at the end of the day, I don't really believe it will get to that stage because the majors see the same things I see in this deposit. I don't see Colossus making it through to actually getting it into production.

TGR: Why hasn't a major picked it off already?

WI: Well, over the years, I've owned a lot of extremely cheap companies and was quite surprised that it took so long for the majors to figure out. One example was Gold Eagle, bought out last year by Goldcorp (TSX:G) (NYSE:GG). I was shocked that it took that long. Aurelian Resources is another obvious example. Aurelian was sitting around for probably a year and a half with a massive gold discovery, extremely cheap—and no major moved on it for a very long time until Kinross Gold Corporation (K.TO) (NYSE:KGC) stepped up. I've seen so many times in the past where you have a tremendous asset that's extremely cheap but it just takes a period of time before the majors move on it. The majors have their own schedule, their own agenda. And it takes them some time to do their level of due diligence and get comfortable with things.

TGR: Switching to base metals, what do you like there?

WI: One of the more interesting plays I like and have been involved in for some time is Noront Resources Ltd. (TSX.V:NOT). I got excited about it in the first place because they drilled what they thought would be a diamond target and hit a very high-grade nickel deposit. They intersected 117 meters of 4.1% nickel, 2.2% copper and significant amounts of platinum, palladium, gold and silver, I was very excited. Unfortunately, the nickel discovery was rather small in size but, as they started looking for more nickel, they discovered a serious and significant chrome deposit.

So Noront is interesting right now. They have a large amount of cash, they're going to be spending about $19 million this year drilling for both high-grade nickel and copper, which they have several million tons of currently. They're also drilling out their chromium deposit, which I believe over time will yield over 100 million tons of chrome ore.

So what I like about Noront is they're in a tremendous, unexplored and target-rich environment. They've had some very good success over a very short period of time in finding both chrome and high-grade nickel. Every day they go out and drill holes, they're building up their resources. If nickel and chromium prices stabilize, which I believe they are doing, it will create shareholder wealth every day.

Looking at the region they're in, it's clear to me that it a very large metal system created this massive chrome deposit and this extremely rich, yet small, nickel deposit. I believe, over time, they will find more of these very rich nickel pods and will be drilling out what could be one of the world's largest chrome deposits, so it's a very exciting story. The valuation is not out of control and they have a very strong board, which we helped put in place last fall. I'm expecting great things from this company over the next year.

TGR: They've certainly had ups and downs in their stock price. What's been going on there?

WI: I think substantial expectations followed the first discovery of the Eagle 1 nickel-copper deposit. At the time, with the very high nickel prices and copper prices, the ore was worth many thousands of dollars per ton—pretty rare in the base metals business. People had assumed that this could be part of an extremely large pod, possibly not unlike the Voisey's Bay Ovoid zone. As they continued to drill, it became clear that this was sort of a one-off pod and to date they've yet to find the major Voisey's Bay-size deposit.

Over time, I believe they will find a significant number of these rich pods. At this stage, I have no idea how large they're going to be, but Noront has a large number of targets left to drill and we'll see how they make out. Nickel prices also dropped precipitously last year; and that, too, had an impact on Noront's valuation. So it was all those factors combined. It seems to me that if they have some success with the drill bit, there's significant upside available to the company.

TGR: You said they will be spending about $19 million this year in drilling?

WI: Yes, it's my understanding they're about halfway through that program. They have enough cash for about 18 months, so they're ready to go with really good management and exploration teams and a solid board of directors. They're moving forward.

TGR: When should we start getting some drill results?

WI: My understanding is that Noront currently has about 50 drill holes in the assay lab, so those results will trickle out gradually. What really excites me, though, is some of the new exploration targets they're going to drill. I believe four drills are going nonstop, and they'll be drilling both nickel and chrome targets. Building out the chrome resources should be considerably easier than building out the nickel resources. It will take some time, but it'll get built up little by little and that's a tremendous resource for them, too. They have lots of chrome on their property and I'm hopeful that they will make multiple, additional significant nickel-copper discoveries. It's a really target-rich environment to be drilling. With a little bit of luck, some really good things could happen.

Warren Irwin is founder, Portfolio Manager and Chief Investment Officer at Toronto-based Rosseau Asset Management Ltd., a top-rated Canadian money management firm that has also earned significant recognition globally. Catering to high net worth and institutional investors, Rosseau specializes in maximizing long-term capital appreciation through North American special situation and event-driven investing. Established in 1998, Rosseau has some C$125 million assets under management, and has made a name for itself as a strong performer in the area of alternative investments. Rosseau's flagship fund boasts a 20.47% average compound rate of return since inception over 10 years ago, compared to 5.67% for the S&P TSX Total Return Index over same period. Warren is rightfully proud of earning such returns against a backdrop of fallout from the Long-Term Capital's implosion and the worst financial meltdown since the 1930s.