THE GLOBAL MINING CRISIS!

A PRECIOUS METALS PROFITABILITY REPORT

LEARCAPITAL
THE PRECIOUS METAL LEADERS

A Lear Capital Publication

The Metal Mining Crisis

When we purchase bullion as a hedge against inflation, or as a store of value in light of soaring Federal Debt, or to simply diversify our portfolio ... few of us wonder where the precious metals actually come from. Our bullion coins arrive in mint condition in a sleeve, sheet, tube, or monster box. They are shiny, lustrous, and pure.

We assume that gold and silver bullion are readily available to us and in ample supply. Rarely do we think about the mining process or the cost of exploring, excavating, and extracting precious metals from rock, soil or caves deep inside the earth. Seldom do we think about the business of finding and refining metals ... the men, the machines, and the terrain. Well that is all about to change because there is a profit crisis occurring in the metals mining sector that will greatly impact supply, demand and future production levels.

While gold and silver prices have fallen, the cost of mining both metals has steadily risen. Mining has seen labor costs rise, material prices surge, and power rates soar. This has put tremendous stress on the profit margins of the major gold and silver producers. With little room to cut a high-cost process, many mining companies are either reducing production or taking smaller mines off line. Others are simply shutting down. All of this translates to less gold and less silver. With demand remaining constant, we are ripe for a significant supply crisis ... particularly if demand rises which it appears poised to do.

Silver and the Precious Metals Price Floor

There is a “survival of fittest” mentality currently operating in the mining sector and there is no doubt that in the coming years many mines will fail or be consolidated. Silver mines are no exception.

Mining silver is a surprisingly arduous process with varying methodology depending upon where the metal is found. Most silver is located underground and predominantly in ore that contains other metals like copper, lead, zinc and even gold. In order for silver to be taken out of the ore it has to be broken, crushed, oxidized, heated, cured and then recovered.

The mines themselves often utilize shafts and lifts, hoists and pulleys. It is a noisy, dirty and pricey business with specialized labor demands and high energy requirements. The precise extraction method varies based upon the content and quality of the ore in which the silver is detected. In zinc-bearing ore, for instance, a molten recovery process is used while copper-bearing ore uses an electrolytic refining process.

In terms of production costs, some experts put silver mining fees as high as $24 an ounce, which would make it unprofitable for the mines to even operate given current pricing trends.

Top Silvers Miners in All-In-Costs

	Company		FY2011	FY2012		Q4FY12
GORO	Silvers ozs:		2,015,900	2,846,906		641,827
	Silver Eq. ozs:		3,288,979	5,526,635		1,418,743
	Cost per Silver eq. oz:	$	13.69	17.75	$	12.70
	Excluding Writedowns:	$	13.32	17.75	$	12.70
AG	Silvers ozs:		7,094,395	7,990,492		2,209,144
	Silver Eq. ozs:		7,457,940	8,818,750		2,458,058
	Cost per Silver eq. oz:	$	18.88	18.44	$	17.71
	Excluding Writedowns:	$	18.88	18.44	$	17.71
PAAS	Silvers ozs:		21,855,000	25,075,298		6,894,166
	Silver Eq. ozs:		31,578,853	36,429,178		9,860,812
	Cost per Silver eq. oz:	$	18.13	23.55	$	29.07
	Excluding Writedowns:	$	18.13	20.81	$	18.93
HL	Silvers ozs:		8,119,634	5,430,252		1,538,162
	Silver Eq. ozs:		15,360,573	11,406,881		3,027,816
	Cost per Silver eq. oz:	$	23.02	26.18	$	26.37
	Excluding Writedowns:	$	23.01	24.62	$	24.58

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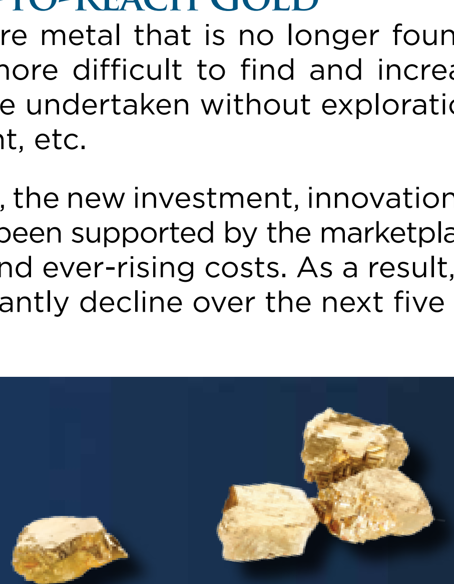
With production costs now approaching and in some cases exceeding the current silver spot price, clearly something has to give. Major silver mining operations have already started to limit exploration, cut labor, and slash production. All of this will obviously shrink supply and with demand consistent in both the industrial and the investment sector, silver is emerging as an attractive, low-cost investment metal poised to soar.

The arrival of a precious metals price floor presents itself rarely in history and in exceedingly few lifetimes. With silver currently selling for less than it costs to locate, extract and refine it ... there is clearly no place for prices to go but up. Add all of the uncertainty of the Debt Crisis, rising Interest Rates, the wind down of Quantitative Easing, and various global currency calamities, and we could be witnessing a momentous correction.

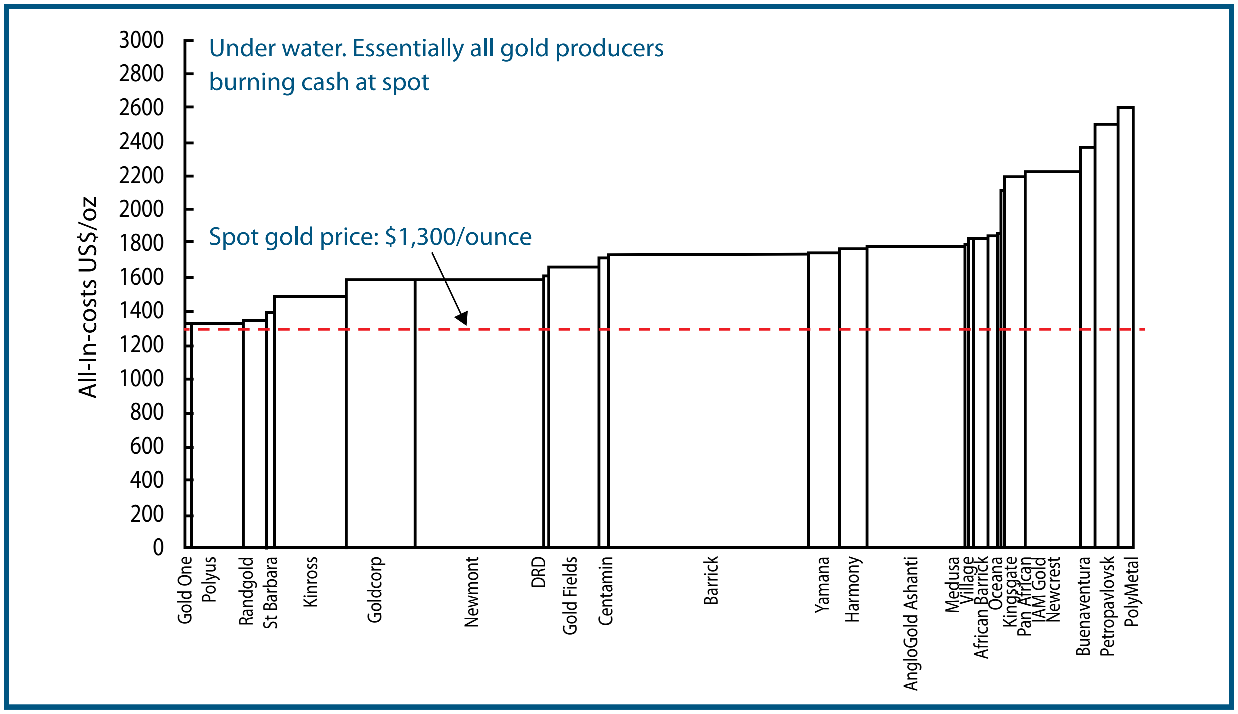
The End of Easy-to-Reach Gold

Like silver, gold is a rare metal that is no longer found in vast, easy to reach deposits. It is becoming more and more difficult to find and increasingly more expensive to mine. Gold mining today cannot be undertaken without exploration, drilling, permits, groundwork, labor teams, bulky equipment, etc.

To make matters worse, the new investment, innovation and expansion put in place by the gold mining sector has not been supported by the marketplace. Mining profits are getting squeezed by falling gold prices and ever-rising costs. As a result, many experts are predicting that gold production will significantly decline over the next five to seven years.



As the chart below demonstrates, many of the world's major gold producers are literally under water at current spot gold prices and are neither generating cash flow ... nor profits.



Courtesy of Citibank

Like silver mining, modern gold mining is highly labor-intensive. Gold is found in very low concentrations in ore. Massive rocks must be crushed and milled down to yield a small amount of gold powder which is then melted down to an even smaller amount of solid gold. The process is lengthy, protracted and utilizes an extraordinary amount of energy, fuel and chemical processing.

Furthermore, it appears that we have picked all of the low hanging gold on the planet and what remains is harder to reach, embedded more deeply in the earth, and only found in more remote and unstable parts of the world. Modern gold producers not only face volatile makeshift governments, intermittent coups, cumbersome taxes, asset seizures but also the new wrath of environmental activism.

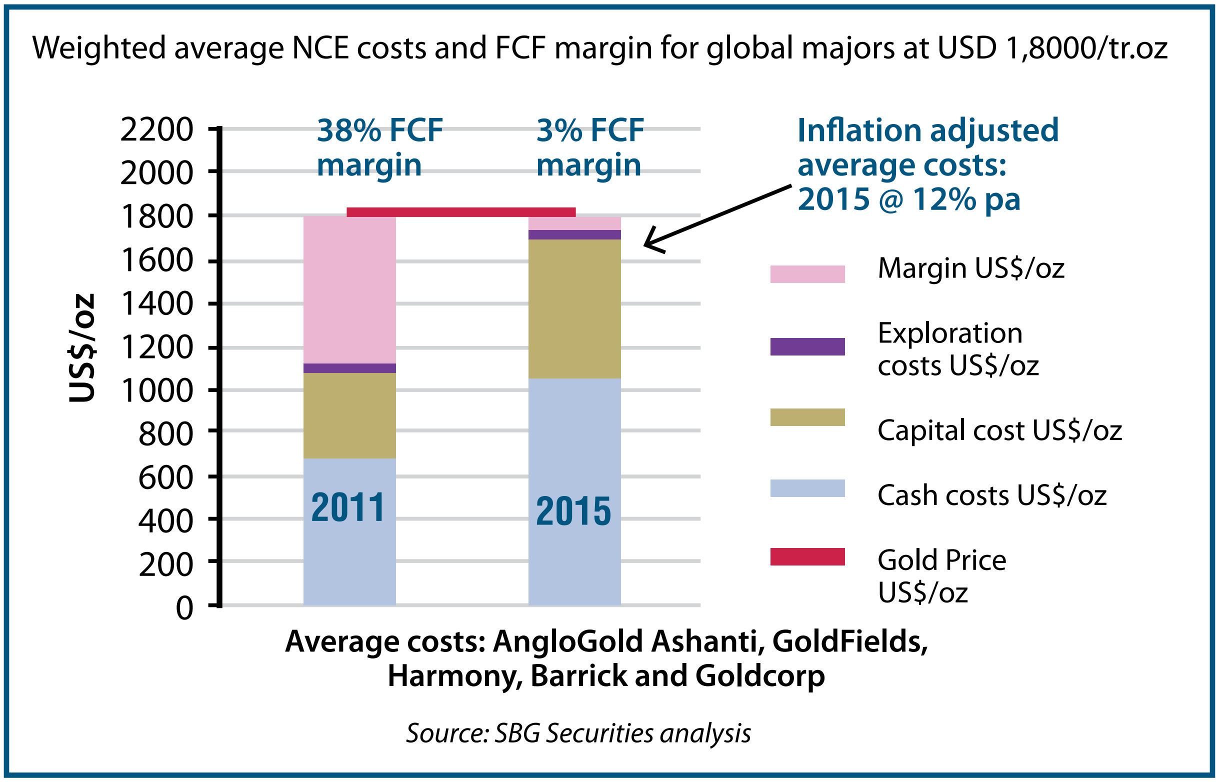
With rising costs and falling profits, gold production is clearly set to fall off. Once there is a measurable reduction in supply, gold has the opportunity for a recovery and even a considerable rally.

A Critical Supply Story

With most silver and gold mines now operating at "breakeven" levels, precious metals producers are simply not making money. This will invariably lead to a stream of bankrupt, sold and/or shuttered mines. There will be less production and less competition.

While investors have traditionally focused on the merits of gold and silver as tangible assets with intrinsic value, a new conversation is emerging about critical supply, and it is perhaps the most powerful market development to overtake precious metals in decades.

The chart below illustrates the shrinking margins, rising capital costs, and soaring cash outlay for some of the major gold producers at $1800 an ounce. With gold currently trading under $1400 an ounce, it gives us a clear idea of how bad things really are for the mining industry.



Once mines start to fold, supply will no doubt decrease. With physical and industrial demand for both gold and silver rising and supply falling, both metals will be driven higher. And this is just the supply side of the story.

The Deep Earth Quandary

Despite mankind's technological advancements, mining is getting harder, not easier. Precious metals have been mined, refined and consumed for centuries and the easy deposits and high yield regions have simply been tapped. The silver and gold deposits that remain are more difficult to find, harder to reach, and more expensive to bring to market.

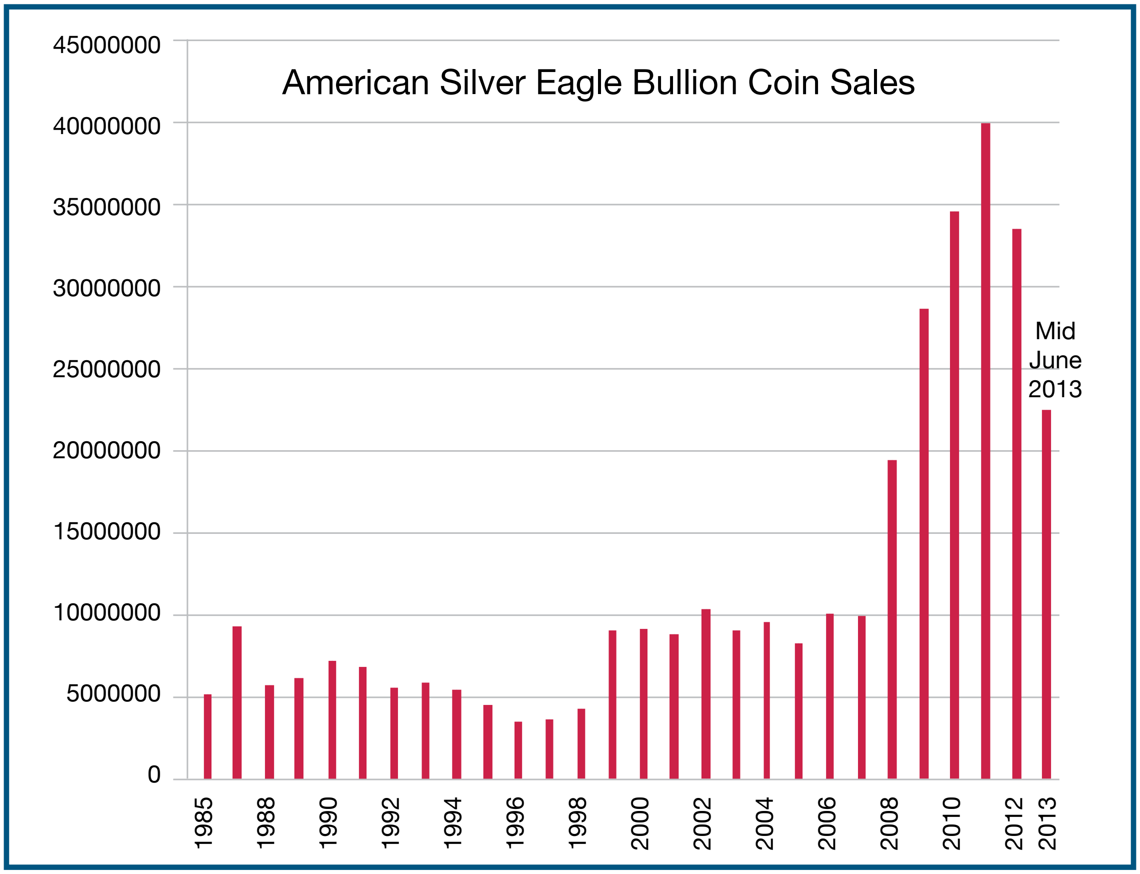
The mining industry has been rattled by rising labor rates, soaring power costs, new provisional taxes, increased royalties, and material and machinery costs that are increasing at a rate of 15% per year. Meanwhile financing to fund new field surveys, exploration, and drilling has simply evaporated. Add new regulations, by-laws, green directives and multi-national bureaucracy, and it's no wonder that we have any raw materials at all.

One might ask why we should care about all of this. The answer is a simple supply and demand metric. The less profit mines make, the fewer that will stay in business. Less mines producing precious metals means less supply and with continued demand ... look for higher prices.

Extraordinary Silver Demand

"Silver has outperformed gold over the last decade in part because of its dual nature, being both a precious metal and also one that has multiple applications in industry and medicine."

Shayne McGuire, Head of Global Research at Teacher Retirement System of Texas



Source: US Mint

Silver is perhaps the most endangered metal on the planet. Silver's use in electronics is legendary. Its ability to transmit thermal and electrical charges is unsurpassed in the world of conductive metals, and it cannot be easily replaced. It is universally used in switches from the light in your living room, to your kitchen appliances, to your automobile components, and just about anything else that you turn on and off in the course of a day. With endless, critical uses and ever-increasing demand, experts estimate that the world's silver supply could be exhausted as soon as 2021.

Modern silver boasts a variety of uses that are inextricably linked to modern life. The industrial demand for silver is soaring since almost all electronics are configured with it. Silver possesses exceptional conductivity and is a reliable electrical pathway. It is found in circuit boards, TV sets, solar panels, telephones, microwave ovens, CD's, DVD's, batteries, hearing aids, film, medical instrumentation, etc.

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Aside from its commercial uses, there is growing investment interest in silver as well. In conjunction with their steady push into electronic fabrication and industrialization, both China and India have been acquiring unprecedented amounts of silver as a viable asset. Now one of the largest silver-consuming countries in the world, China has taken the additional step of encouraging its citizens to purchase silver bullion, even making it available for sale at local banks. So if the dramatic increase in demand in the industrial sector were not enough, silver is also being rediscovered as a secure and low-priced investment vehicle around the globe!

In the first quarter of 2013, sales of the 1 ounce American Silver Eagle bullion coin broke all sales records. The US Mint recorded 14,223,000 Silver Eagles sold through March 31 including several weeks in January when there were zero sales because the US Mint's entire stock of the popular coin was sold out. The over 14 million Silver Eagles sold was more than the entire annual sales of Silver Eagles from 1986 through 2007. First quarter sales for 2013 were 15% higher than 2011 which was heretofore the best year ever for the Silver Eagle Bullion coin.

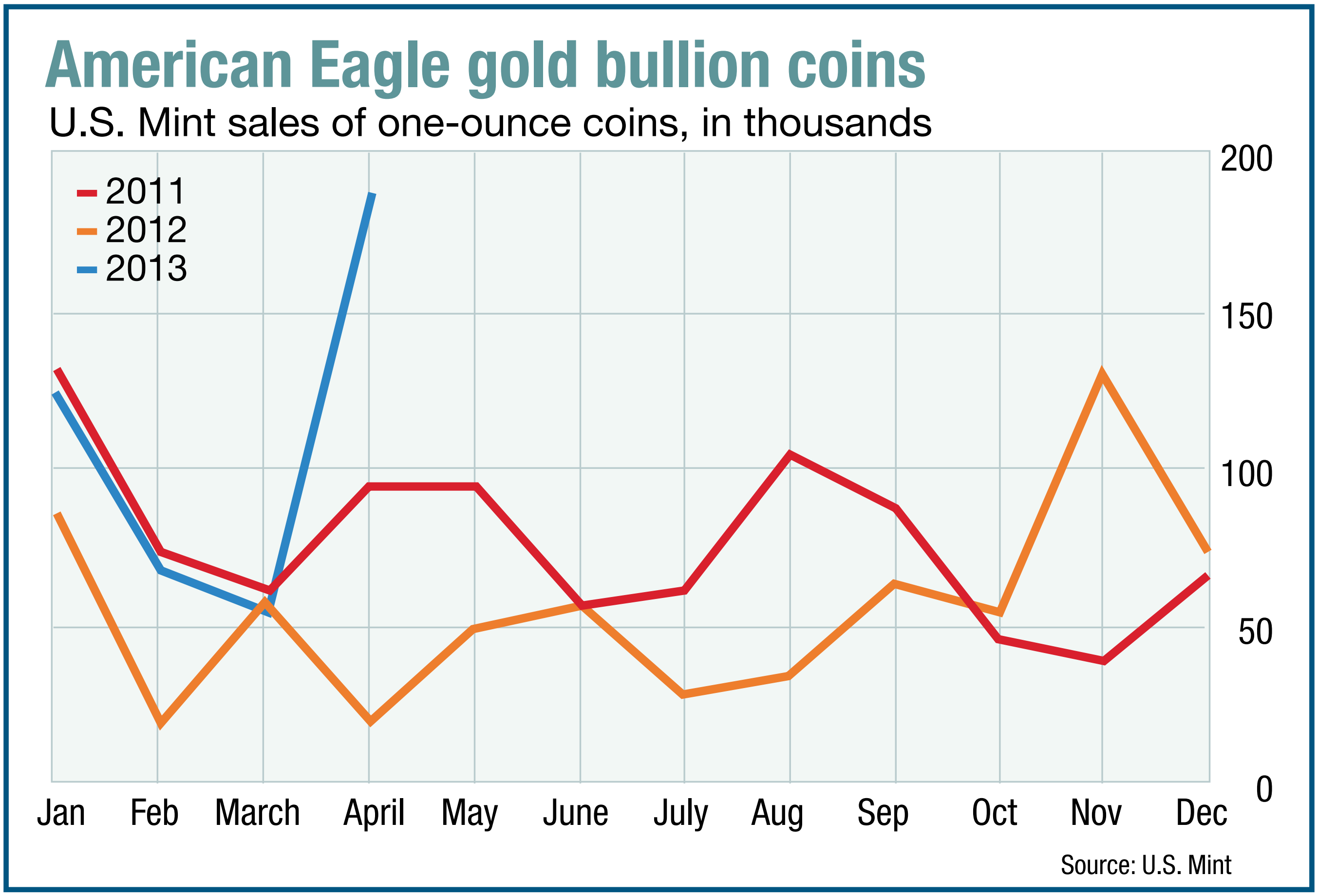
If the current pace holds and supply does not again run out, 2013 is on course to sell an astounding 45 million Silver Eagle Bullion coins.

The 1 ounce Silver American Eagle

Multinational Gold Demand

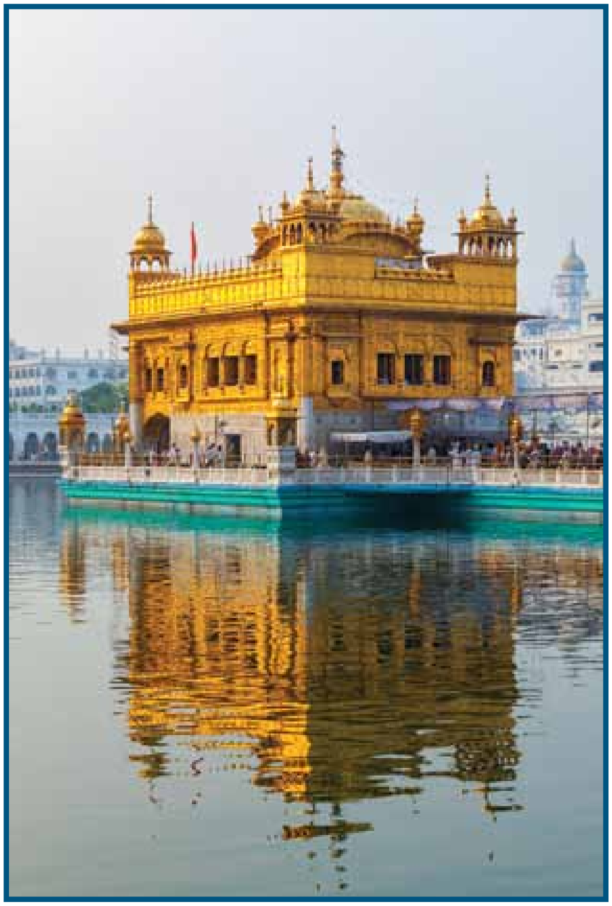
"There has been very good demand for physical gold this year.....China is going to come in between 900 and 1,000 tonnes this year for the full year. Last year was a record at 776 tonnes, so that gives you the best indicator."

Marcus Grubb – World Gold Council - Managing Director of Investment



The World Gold Council conducts perhaps the most in-depth analysis of all the factors that impact world gold supply. It has indicated that supplies of the world's most precious metal have clearly been diminished by widespread production cuts within the mining sector and the stark realities of non-profitability. As a result, the cost of borrowing gold has surged to its highest levels in over three years due to marked shortages coupled with steady demand, particularly from Asia.

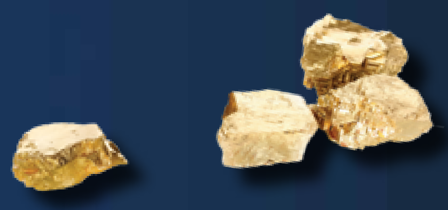
Physical demand for gold in both China and India remains at very high levels with China's demand curve rising more rapidly. In China, net gold imports rose 40% in May and current demand remains robust as the Shanghai Gold Exchange supplied 1,098 metric tons of gold through June of this year compared with just 1,139 tons for all of last year.



India's love affair with the precious metal also shows no signs of softening or subsiding. Gold has a special place in Indian culture and society as an enduring symbol of wealth, status, worship and celebration. In India, gold is the ultimate possession and acquiring it is a lifelong goal. Indians privately hold more than 20,000 tons of gold and as India has emerged as one the fastest growing economies in the world, they are now also the largest consumers of gold. Despite new government tariffs on gold imports, forecasts for a good Monsoon and Wedding Season should push Indian gold imports even higher.

Around the globe, the gold market continues to move away from paper in favor of physical gold as buyers are finding limited stock on bullion coins and small bars. Demand on government mints and bullion dealers is now the strongest since the collapse of Lehman Brothers back in 2008 with heavy long-term gold buying and little short-term selling.

With gold cherished as a cultural and timeless investment icon in both China and India, global demand for gold will continue steady and should far outpace domestic demand in the US. Unless, of course, the American economy stumbles. A new round of negative indicators, a sudden fiscal setback, or if the Fed finally pulls the plug on Quantitative Easing … which we all know it must do at some point … gold demand could soar into the stratosphere.

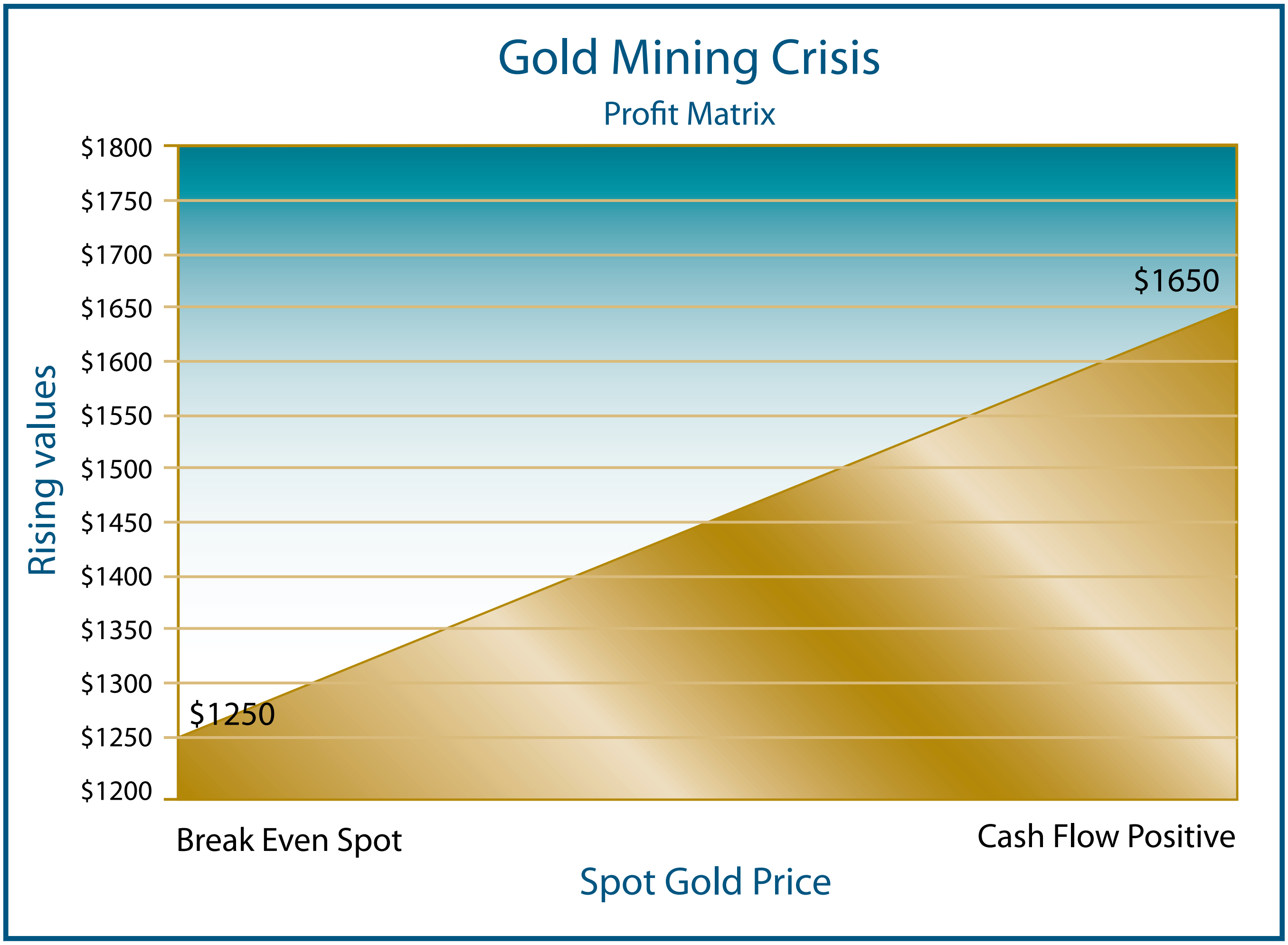


The Opportunity

The impact of supply and demand on precious metals prices is an economic principle that has proven itself for centuries. Obviously if we can catch the curve at the right time, there are fortunes to be made. The question for investors is ... *"Is now that time?"* It's a fairly simple proposition, and there is a highly plausible upside given a straightforward set of assumptions.

Silver is currently trading at around $20 an ounce. The mining industry tells us that they need to be at $24 an ounce to breakeven. But, mining is a business and few businesses can stay afloat without recording a profit. So, the spot price for silver actually needs to be higher than breakeven to keep the world's silver mines open, operating, and productive. If we add a standard 10% margin to the industry's breakeven spot price to keep operations running and profitable, it brings silver to a conceivable spot price of $26.40 an ounce. If silver moves from today's $20 an ounce to a plausible $26.40 an ounce ... it represents an increase of almost 25%!

The spot price scenario for gold is even more noteworthy. Most gold producers are reporting a $1250 per ounce spot price as the breakeven figure to mine gold and cover all of their skyrocketing labor, equipment, and production expenses. They anticipate that supply, demand and the economies of profit and loss will necessarily drive gold to approximately $1650 an ounce where the industry will once again be Cash Flow Positive.



The reality here is that silver and gold have clearly over-corrected and are now both currently selling well below industry production costs. We believe that this cannot be sustained, and they are poised to rise to cash flow positive levels!

Even if none of the other factors that typically drive precious metals prices are in play (i.e. US Debt, rising Interest Rates, the end of QE, inflation, the Euro Crisis, the Dollar Crisis, etc.) the rising production costs and soaring demand alone should drive spot prices higher. And, any single one of the other tinderbox economic issues would simply be an extra premium on your investment.

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