

Growth Stocks Weekly

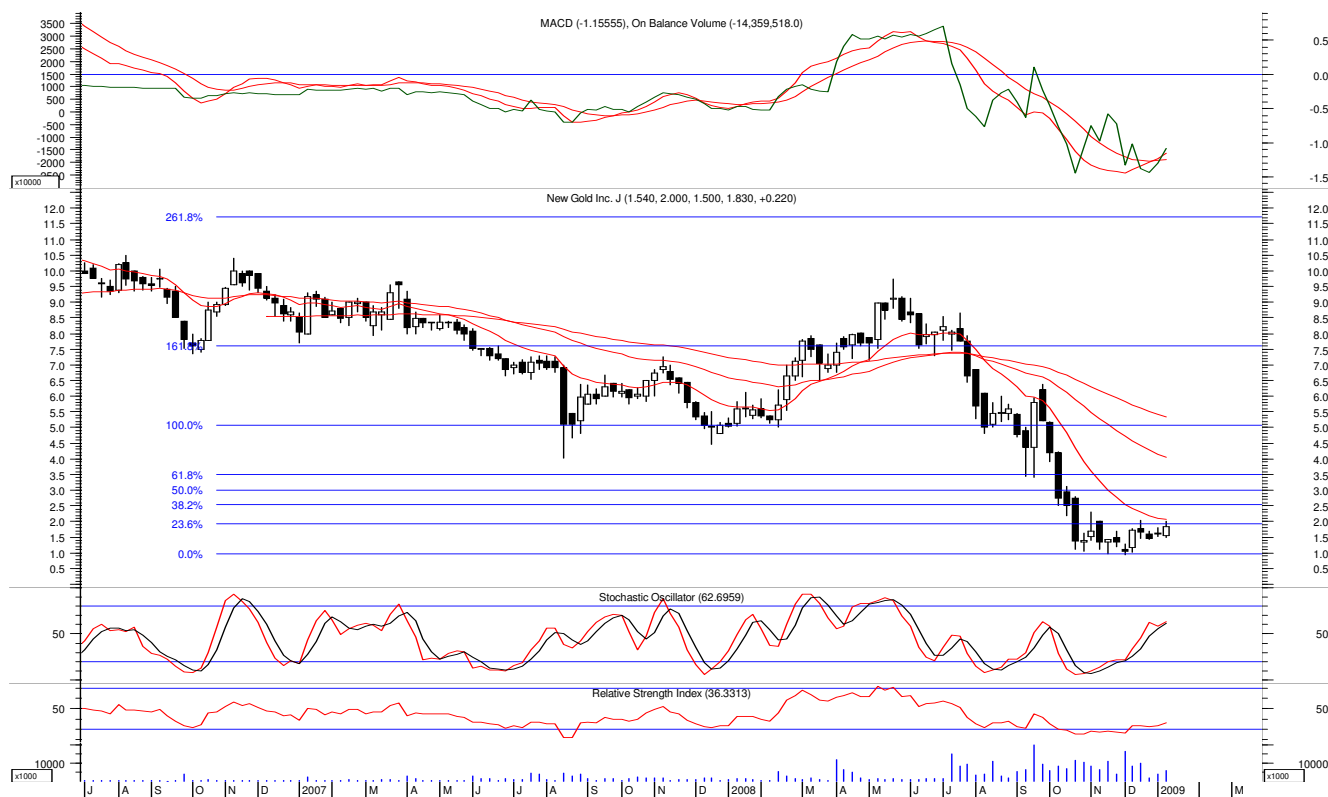
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Performance: 1996 116.9%; 1997 28.1%; 1998 36.4%; 1999 39.4%; 2000 180.9%; 2001 -50.5%; 2002 18.7%; 2003 28.8%; 2004 166.7%; 2005 28.2%; 2006 153.3%; 2007 8.8%; 2008 -25.2%

Junior Gold and Natural Resource Sector Report

January 11, 2009

New Gold (NGD-TSX Venture)



Weekly chart: High C\$9.75, Low \$0.94, Last Trade \$1.83

New Gold is a cash-flow-positive gold producer with significant gold reserves and production, given little value by the market today.

New Gold's share price has declined from a high of \$9.75 last year to low of \$0.94 on December 3rd, well below its cash value. On December 2nd we sent out an alert and added 100,000 to the model portfolio at an average \$1.05 per share, to hold 160,000 shares.

Legendary gold investor Seymour Schulich, along with partner Pierre Lassonde, are the creators of the original Franco Nevada gold royalty company, and built it into a multi-billion dollar company. Schulich and Lassonde each own about 5% of the new NewGold. They say Schulich has the Midas touch. Add to that the Endeavour Financial team of Frank Giustra, along with Ian Telfer (ex-CEO of both Wheaton River Minerals and Chairman of Goldcorp) and you have a dream team.

New Gold is a "must own" holding during this gold bull market. Website: www.newgold.com

Review

A merger between Peak Gold, Metallica and New Gold was completed in July 2008, just ahead of the largest market crash of a generation unfolding. We inherited our interest in New Gold via our Peak Gold portfolio position accumulated while it was still a shell.

Our last report, on Peak Gold (PIK-TSXv), was issued Feb 18, 2008 and is found [here](#). For newer subscribers who may have missed the "good times", we positioned our subscribers into Peak's predecessor "shell" called Imperial Plastech between early May 2005 through late 2006, accumulating 650,000 shares at an average cost in the low \$0.30's. The payoff came by early 2007 as we sold off most of our shares as the stock ran up through the \$1.10 area, on rising volume with no news.

What attracted us to the shell was the share structure, and sponsorship of the Endeavour Financial Group, which had acquired effective control of the company. Soon thereafter Endeavour proved its worth once again, reassembling the original Wheaton River team, and announcing a \$326 million financing and acquisition.

We reacquired a small position in Peak Gold last year and added to it on weakness in the \$0.40's as per our alerts. Post merger (on the basis of 1 share for every 10 we owned), we then held a total of 30,000 shares, and in August 2008 we added another 30,000 shares at \$4.91 per share.

Recent Events

New Gold was hit a lot harder than most gold stocks these last four months. This created an opportunity to switch into New Gold from small exploration-stage gold mining companies that are a long way from production.

New Gold's operations performed worse than anticipated since the three-way merger. At the time of the merger the combined company was expected to produce 300K ounces for the year at a cash cost of \$400/oz, rising to 350K ounces in 2009 and about 500K ounces in 2010.

2008's production rate fell to around 250K ounces at \$510/oz and growth expectations also fell. While the market environment of the past few months has often resulted in +75% reductions in market capitalization for commodity-producing companies that have done things right, companies that have made any missteps whatsoever have been hit harder. Still, company-specific shortfalls do not justify New Gold's stock's performance.

New Gold's Q3 results showed a loss of \$148.9 million, but this was because they wrote down \$156.9 million on their Amapari Mine in Brazil. Without the writedown, the company was actually profitable by \$8.0 million. Cash costs per gold ounce were \$566, but at today's \$850/oz gold the company is cash flow positive and profitable.

In early December 2008 we stated that New Gold's Amapari mine would probably operate until Q4 but after that, or maybe sooner, it would probably be shut down, given the severe operational issues. The mine had already effectively been written off, but continued to be a drain on cash flow, so we figured a shut down would be a big positive. On January 2 New Gold placed Amapari on "temporary care and maintenance" pending the results of a preliminary economic assessment, expected in Q1 2009.

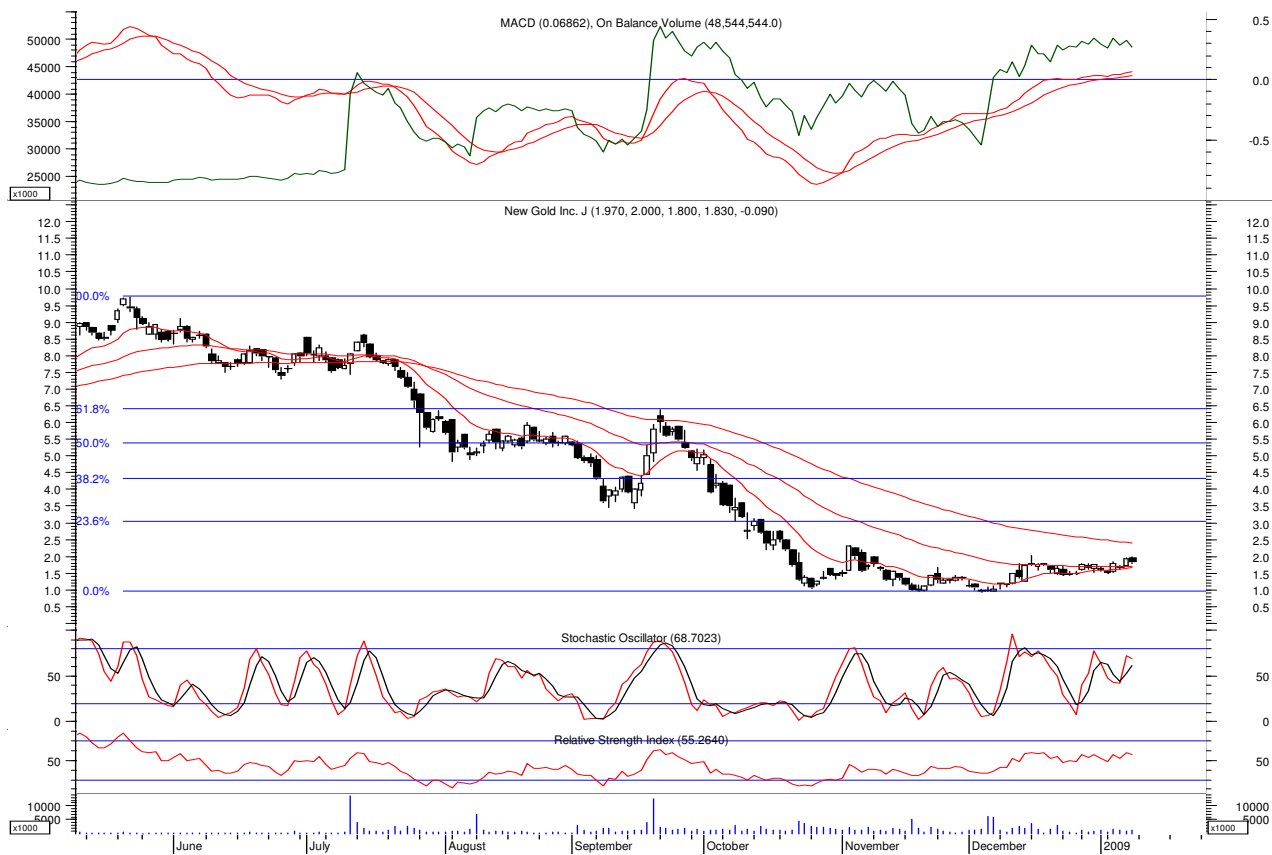
Operationally New Gold's Q3 gold sales increased by 7 per cent to 67,156 ounces over the prior quarter, and recently projected gold production of 250,000 ounces for the year was still on target. New Gold also decided to go slow to develop their Afton project in an effort to maintain a strong balance sheet, given the current economic uncertainty.

Base-Case Valuation

To get to a conservative valuation per share for New Gold, we can take away all the uncertainty by getting out the machete and hacking off some of the meat on the bones. Let's assume that Amapari is absolutely worthless, that all of New Gold's large cash reserve will be consumed in the development of the New Afton project, that the huge El Morro copper/gold project will never get developed (so New Gold's 30% stake is worth nothing), that none of the \$170M invested in Asset Backed Commercial Paper (ABCP) by pre-merger New Gold will ever be recovered (this investment

was already written down to about \$90M at the time of the three-way merger and does not form part of the company's cash reserve, and has never been included in our valuation estimates).

In this unlikely scenario New Gold ends up a 300,000 oz/yr gold producer with a relatively low cash cost. By using a relatively conservative valuation of US\$2,500/oz to these production results, you get a market cap of \$750 million, or about US\$3.50/share (US\$1.90 fully diluted).



Daily chart: High C\$9.75, Low \$0.94, Last Trade \$1.83

Technical Comments

The share price has been working higher off an effective triple bottom, with all the lows in the \$0.94 to \$1.00 range made during the severe panic lows set during the October through December period. MACD and OBV continue to be positive and price has moved above the 13 and 40-day moving averages (MA) which are set to cross to the upside early this week at the \$1.60-1.70 area, which should form short term support. The \$2.06 area of the still-declining 13-week MA is a resistance area, as is the \$2.25 Fibonacci Retracement and the \$2.40 80-day MA. At the current \$1.84 close the Relative Strength Index is neutral while the Stochastic Oscillator is overbought and suggestive of a short term correction. We suspect that buying on weakness will reward investors well over the next six months to a year.

 Current Price: C\$1.83
 52 Week Range: C\$0.94 - C\$9.75
 Shares O/S: 213 million basic
 Shares O/S: 296 million fully diluted
 Market Cap: C\$390 million
 Cash on hand: US\$151 million (Sept 30, 2008)

Where to Gold?

Over the past five years, to the end of 2008, gold's price has surged more than 110 per cent; gold stocks, as represented by the Philadelphia gold and silver index, have risen just more than 20 per cent. Over the past 10 years, the performance gap has been similar, with gold outperforming gold stocks by 80 percentage points.

The natural conclusion here is that gold stocks may not be worth the effort - especially when you consider that they come with the extra risk of management performance, hedging strategies and the political risks of mining in relatively unstable parts of the world.

However, some observers believe that the relative performances of gold and gold producers move in cycles, and a switch could occur. Gold outperformed gold stocks in the second half of the 1990s. Gold underperformed gold stocks from about 2000 until 2003 - and the two were battling it out until the disastrous performance by gold stocks this last year.

There is some evidence to suggest that gold stocks could start to shine. John Hussman of Hussman Funds compared the price of gold with the Philadelphia gold and silver index to come up with a ratio. Right now, that ratio is more than 7, which is exceptionally high by historic standards.

According to Mr. Hussman, when the ratio is above 5, gold stocks follow with average annualized gains of almost 90 per cent. When the ratio is above 5 and the U.S. economy is weak (as determined by manufacturing activity, or the Purchasing Managers Index, which is in the ditch these days), gold stocks have risen at an average annualized rate of more than 125 per cent.

Gold producers certainly have some make-up to do after their abysmal performance. Perhaps they can redeem themselves in 2009.



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