

ZINC – STORM CONTINUES TO BREW

Analysts continue with bearish forecasts of increasing zinc inventories and lower zinc prices. A good example of this bearish outlook is CRU continuing to forecast zinc prices as low as US\$1600/tonne by the end of 2008. Short positions have also risen in the past couple of months as commodity traders seek to drive the zinc price below US\$2200 per tonne in expectation of rising inventories; yet the market has only succumbed to these pressures this past week with zinc declining to US\$0.94 per pound. Can the analysts be wrong and will any short covering lead to a rally in zinc prices? The magnitude of inventory build-up this year and next will determine the overall direction of zinc prices.

This past week, Don Lindsay of Teck Cominco stated “falling zinc prices could result in the shutdown of unprofitable zinc mines, which in turn, could result in a deficit in the metal in approximately 18 months” (Bloomberg May 23, 2008). Teck Cominco sees the market swinging into deficit in 2010 and 2011, from the current surplus. Salman Partners sees zinc price decreasing to an average \$0.77/lb in 2009 and increasing to \$0.98/lb in 2010 (see cash cost curve on page 3).

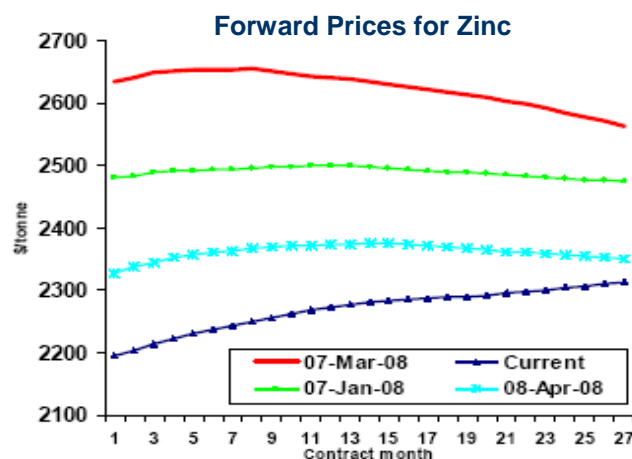
As the charts below illustrate the magnitude of the forecast inventory build-up continues to be downgraded to what is now a modest increase of less than 200,000 tpa. If Teck Cominco is correct and unprofitable mine production is shutdown, the rebalancing of mine supply may happen sooner than the market currently expects. Add to this that many of the new mine projects that are included in supply forecasts are delayed due to financing and permitting, and supply deficits may be sooner and deeper than most think – the storm is brewing.

The hint of the storm was brought home by the potential loss of significant production due to the major earthquake in Sichuan Province Western China. Initial concerns of loss of as much as 500,000 tpa of zinc production would certainly have changed the structure of the zinc markets; however, more recent forecasts are about 30,000 tonnes over 2008. There are also expectations of some new demand created by reconstruction efforts. The market response was small and short lived.

Another cloud on the horizon is the development of a new environmental coalition to try and block the diversion of the McArthur River for the new super pit at Xstrata’s Mt. Isa Mines operations in Australia. At possible risk is 275,000 tonnes of zinc mine production that could see interruptions.

Another indicator of the outlook for metal prices and market fundamentals, that has proven to be quite accurate over the recent months, has been the forward curves for the base metals. Recently, zinc prices have moved strongly to contango suggesting that current supply forecasts are too optimistic. Higher forward prices for base metals, particularly for zinc, is relatively rare and is an obvious warning that zinc may be oversold.

One message is clear, most analysts are in agreement that post 2011, zinc supply will be in shortfall and higher prices are on the way. Macquarie (April 2008) has forecast a rise in zinc price to US\$1.50 some time in the next five years; some of us think it will come sooner than that. Remember, zinc peaked at US\$2.09/lb in Nov 2006 and can do it again.



Source: LME, Macquarie Research, May 2008

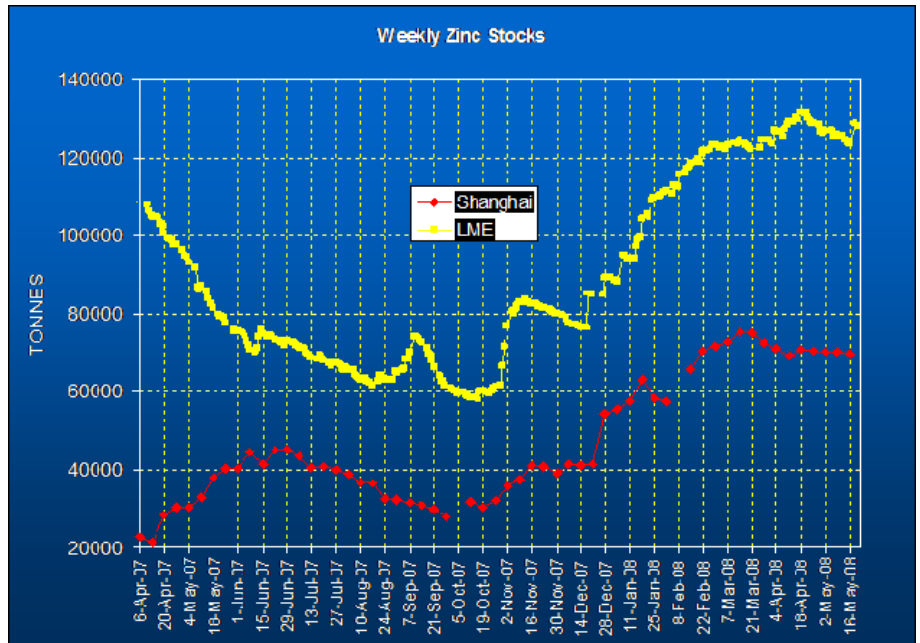
Note to Reader: This overview is intended to provide readers with useful information on the usage, supply, production and consumption of zinc. The overview has been assembled from a large number of information sites that are believed to be reliable; however, the companies make no representations as to the accuracy or completeness of the information herein. The reader should use this information for general purposes only and seek advice from its investment advisors as to the details of zinc markets.

ZINC MARKET HIGHLIGHTS

Metal Inventories

Zinc inventories remain relatively low with aggregate inventories in the London Metal Exchange and Shanghai warehouses at approximately 198,000 tonnes; an increase of 110,000 tonnes from their early Oct 2007 lows. After a good run up in second half of 2007 and Q1 2008, inventory growth has levelled off and declined slightly. Certainly this hiatus in inventory buildup was not predicted by the analysts and may very well be signalling that demand is stronger than expected and mine supply more anaemic than assumed.

January forecasts for 2008 inventory increase were generally in the 300,000 tonnes range; more recently International Lead Zinc association has forecast an increase of 215,000 tonnes for 2008. Year-to-date increase (almost 5 mths) has been only 54,000 tonnes.



With most stockpiles of Red Dog concentrates now processed, concentrate availability could tighten until new shipments become available in late summer. The near term supply outlook is now tempered by the potential effects of the recent major earthquake in China and other possible disruptions.

The recent earthquake in Sichuan Province has raised concerns of loss of supply due to damage and power disruptions: smelting and mine output potential losses in the near term are both estimated at approximately 200,000 tonnes per annum. The loss of any mine and smelter production from mines and smelters in Sichuan Province, combined with shutdown of small mines due to declining zinc prices and higher treatment and refining charges, and other news that Chinese smelters are running at reduced output due to power shortages, all suggest that the potential loss of output in China may be more than enough to ensure no deficit in zinc supply in 2008.

The one major supply addition for zinc comes from Hindustan Zinc with mine expansion at Rampura Agucha open pit mine from current 500,000 tpa to 690,000 tpa zinc and 105 tpa lead output by 2010. The Sindesar Khurd underground mine (75,000 tpa zinc and 50,000 tpa lead) is planned to be on stream to help feed the new 210,000 tpa smelter. Another small mine at Rajpura Dariba is to start up by early 2012. India continues to expand its production to meet growing local demand.

Zinc Prices

Zinc prices along with other metals undertook a significant decline during the past week as long interests are liquidated. As zinc prices have fallen, cancelled warrants on the LME have increased indicating that fabricators are taking advantage of the decline in prices.

The market reacted to the earthquake news with a 6.7% increase in zinc price to US\$1.04 /lb; but, has subsequently made new recent lows of US\$94.6/lb as fears of inventory build-up continue and last weeks general market liquidation of long positions.

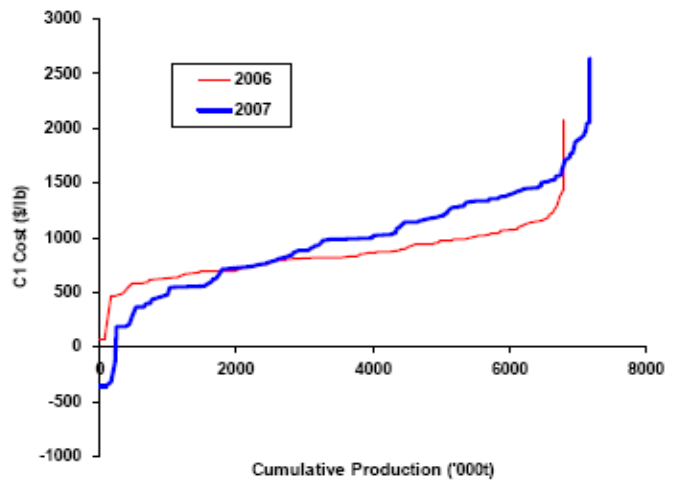
In general the forecasts are for lower prices in 2008 and 2009 as recently stated by Teck Cominco, with lows expected in the US\$1500 to US\$1600 per tonne of zinc.

Cash costs of Western World Production increased significantly during 2007, particularly for the upper quartile of the cost curve. Significant production is lost between US\$0.90 and US\$0.70 per pound of zinc. The increasing cost of production will also be further impacted negatively by current historically high treatment and refining charges.

Any additional price decline or supply disruptions could change the price outlook significantly as it will only take a loss of 100,000 to 200,000 tonnes to rebalance the zinc market.

The sharper the price decline the sooner supply balance will emerge and the long term supply shortfall will prevail.

Cash Cost of Western World Production



Source: Brook Hunt, Macquarie Research, February 2008

WORLD PRODUCTION DOWN GRADES

Updating of the chart from the Jan 11, 2008 Zinc Letter illustrates the downgrading of mine supply and refinery output with new lower output forecasts from Brook Hunt (April 2008). Significantly, mine production forecast for 2008 has been reduced by 100,000 tonnes from a month earlier; however, with market adjustments the forecast is now 12.22M tonnes for 2008. Although the new numbers look encouraging for 2008 the metal balance for 2009 suggests that the worst is still to come, as the forecast for 2009 suggests a very significant slowdown in consumption in 2009, resulting in a significant metal surplus in 2009 – contrarian views suggest that the surplus will be much smaller.

If the forecast major economic slowdown in 2009 does not materialize, the return to supply deficits and a major zinc price rally will start earlier than forecast.

Brook Hunt Jan 2008	2005 ktonnes	2006 ktonnes	2007 Ktonnes	2008 Forecast Ktonnes	Apr 2008 Forecast Ktonnes	2009 Forecast Ktonnes	Apr 2009 Forecast Ktonnes
Mine Production	9,948	10,377	11,323	12,498	12,220	13,427	13,267
Refinery Supply	10,114	10,505	11,353	12,517	12,148	13,253	13,243
Consumption	10,717	11,155	11,565	12,106	11,896	12,635	12,387
Concentrate Balance	32	35	229	161	231	387	128
Metal Market Balance	-540	-625	-212	411	251	618	856

In these forecasts, the major uncertainty and market risk therefore continues to be whether there will be a significant downturn in world economic growth and zinc consumption in 2009. A contrarian view might be that once the Beijing Olympics are over, China will get back to business.

Mine Supply and New Mine Addition Concerns

The downgrading of mine supply reflects a combination of a number of project delays and early shutdown announcements. Teck Cominco announced an earlier shutdown for Lennards Shelf deposit (75,000tpa) from 2011 to Q4 2009. Recently, Lundin Mining citing challenging political issues indicated that it might sell its 49% interest in the Ozernoye deposit in Russia. Ozernoye is the sixth largest undeveloped zinc deposit in the World (157 million tonnes grading 5.2% zinc and 1.0% lead) and the largest of the announced new mine additions. The deposit was scheduled for production of approximately 300,000 tpa in 2011; its delay will have a significant impact on forecast zinc mine supply.

Importantly, much of the forecast new mine supply is outside China whereas the excess smelter capacity is inside China which is certain to result in tighter concentrate markets going forward.

Concentrate Imports and Refined Metal Output

Imports of zinc concentrates and residues into China were up strongly in first quarter, up 63.6% to 595,782 tonnes (Brook Hunt April 2008). To meet current 2008 production forecasts of 1,070,000 tonnes, Chinese concentrate imports will need to be maintained at 90,000 tonnes per month; marginally higher than in the first quarter.

Chinese mine production of 571,360 tonnes in Q1 was well below peak 2007 production but well ahead of the same period in 2007. Mine production will need to increase to 300,000 tonnes per month to achieve the forecast production of 3.4M tonnes that is factored into current forecasts. This is possible, but the potential to disappoint is high; particularly with current low zinc prices that will make many of the small mine restarts of 2005-2006 uneconomic.

Despite strong concentrate imports, refined zinc output was only 315,868 tonnes during Q1, due to power and weather problems in January and February (Macquarie Apr 28, 2008). Smelters should now have reasonable concentrate inventories allowing increased zinc production in Q2. The April earthquake is not expected to have much impact on zinc production; with the main factor controlling output being power availability.

Zinc Consumption and Galvanized Steel Production

As China consumed 30.5% (3.531M tonnes) of the World's zinc in 2007 it is by far the most important factor in zinc consumption. China's demand grew by 11.5% in 2007 and is expected to grow by about 9.5% in 2008. Leading much of this growth is the increase in galvanized steel production and consumption.

China experienced a dramatic 45% increase in galvanized steel production in 2007 to 18.8Mt which largely fulfilled local galvanized sheet consumption of 19.1M tonnes. Similar to galvanized sheet production, continuous galvanized steel is expected to increase 39% in 2008 to 27M tonnes. The rapid increase in consumption of galvanized sheet and continuous galvanizing products in China augurs well for overall increased zinc consumption and continued low export levels as zinc smelter capacity increases.

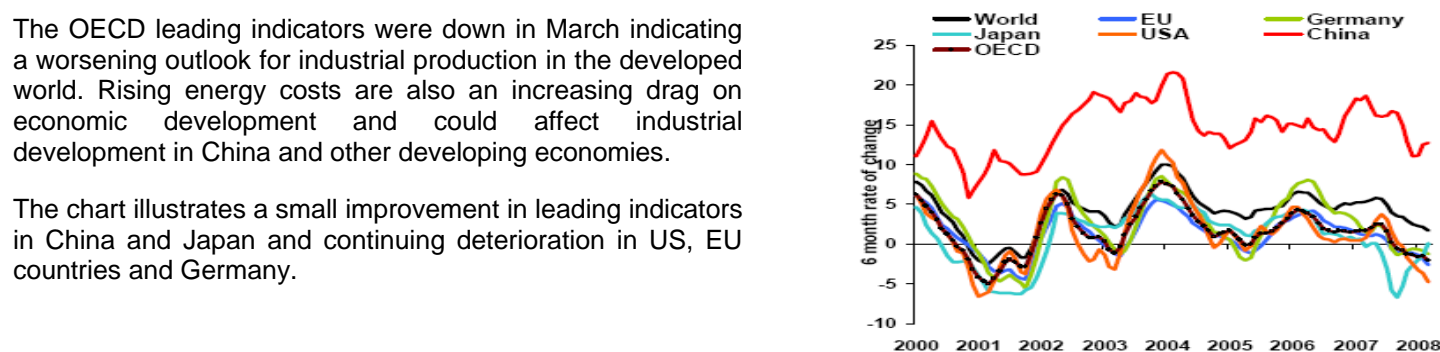
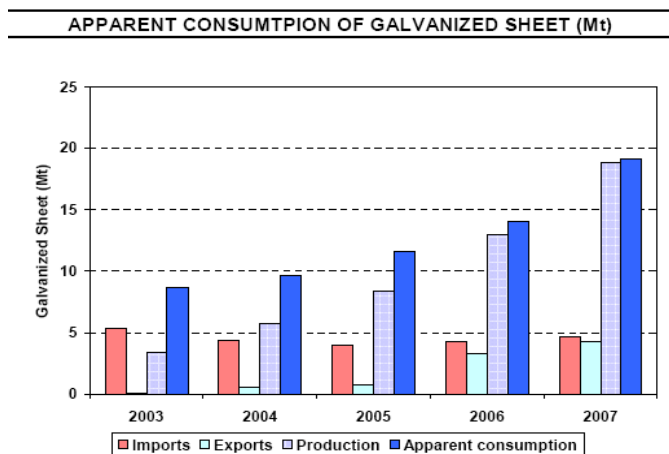
Zinc consumption in China is expected to slow with the forecast 6% average annual growth in 2010 and beyond. Nonetheless, consumption is expected to grow from the current 3.5M tonnes to 8.1M tonnes by 2020, an increase of 4.6M tonnes. Addition of this much new mine production

will require a sustained period of high prices to finance new mines. This is made even more daunting when one considers the "Shutdown Chart" illustrating the loss of 2.1M tonnes of current mine production (see Jan 11, 2008 Zinc Letter).

ECONOMIC OUTLOOK – MURKY AT BEST

The OECD leading indicators were down in March indicating a worsening outlook for industrial production in the developed world. Rising energy costs are also an increasing drag on economic development and could affect industrial development in China and other developing economies.

The chart illustrates a small improvement in leading indicators in China and Japan and continuing deterioration in US, EU countries and Germany.



On a slightly brighter note, US housing starts were up 8.2% MoM in April, but down 30.6% YoY with growth strongest in the condominium market. Decline in the US Purchasing Managers Index (6 mth forward) appears to have bottomed in April suggesting that the contraction in the manufacturing sector may be ending. More importantly, Industrial Production growth in China has risen in the past two months and IP growth remains strong at 15.7% YoY for April 2008 as compared to growth of 18.5% for all of 2007.

India, Japan and Korea are increasingly becoming important factors in uplifting slow economic growth in North America and Europe and in particular metals consumption. Industrial Production growth in India, Japan and South Korea increased 9.9%, 2.8% and 6.8% respectively in 2007. Forecast IP growth for 2008 in China, India, Japan and South Korea are 15.7%, 7.4%, 2.2% and 4.5% respectively; considerably better than that forecast for United States, Eurozone and Germany at 1.6%, 2.1% and 3.0% respectively. However, IP growth for February in China, India and South Korea was well ahead of the annual forecasts; which may indicate that the slowdown in 2008 may be less than forecast.

LEAD MARKET FUNDAMENTALS

In previous zinc letters we have not commented much on the lead markets; however, lead is a major component of production for the Selwyn Project, and we will provide some background information on the lead supply and demand.

Lead prices have enjoyed a sustained period of high prices and a correction was widely expected within the industry.

The dramatic price decline during the past couple of weeks in response to increased open interest as short selling builds and forward prices shift to contango. Short cover buying could provide a significant price rally.

Supply and Demand

More than half of refined lead production comes from recycled lead. Consumptions is forecast to grow at an average 4.5% rate due to high battery consumption with new vehicle and motorized bicycle usage in Asia. China's battery production was up 20% YoY Q1, reinforcing its position as the primary consumer of lead at 31% of world consumption.

Macquarie's new forecast for lead reflects a downgrading of refined production by 360,000 tonnes due to reduced concentrate imports into China and resultant reduced refined lead production growth in China from 20% to 16% for 2008; largely due to historically low treatment and refining charges. Lead exports from China were down 42% for Q1 2008 as compared to Q1 2007; exports from China are expected to remain low over the remainder of 2008. Lead apparent demand increase was modest at 4.4% for Q1,

Sustained high lead prices will result in more primary lead mines such as Ivernia's Magellan mine in Australia. Increasing concerns about lead pollution at Xstrata's Mt Isa Mine and resumption of transport of Ivernia's lead concentrates (3% of mine supply) could result in future supply disruptions. The major new mine production for 2008 is approximately 50,000 tonnes from Apex Silver's San Cristobal mine in Bolivia.

Lead will remain vulnerable to any global economic downturn. Increased zinc production will also bring increased mine lead output.



Macquarie April 2008	2007 ktonnes	2008f ktonnes	2009f Ktonnes	2010f Ktonnes
Mine Production	3,465	3,747	4,128	4,416
Total Production	8,001	8,457	8,893	9,551
Consumption	8,167	8,539	8,984	9,471
Refined Balance	-166	-82	-1	80
Price Forecast US\$/lb	1.168	1.316	1.20	1.30