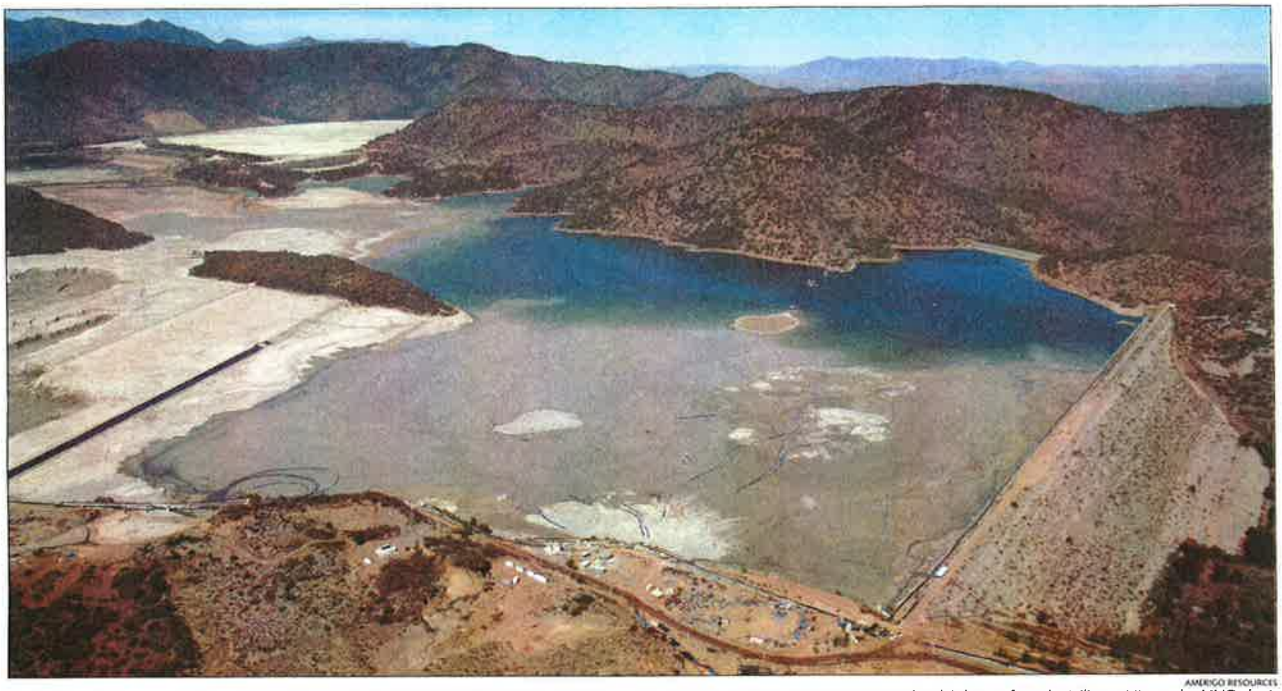
El Teniente's tailings offer dividends for Amerigo



AMERIGO RESOURCES

The Colihues tailings pond holds waste from Codelco's El Teniente copper mine near Rancagua, Chile. Amerigo Resources extracts copper and molybdenum from the tailings at its nearby MVC plant.

BY TRISH SAYWELL

Over the last 40 years, Klaus Zeitler has financed, built and managed base metal and gold mines in Europe, Africa, North and South America and the Pacific.

His career started at German metals conglomerate Metallgesellschaft AG where he served as managing director, and officially ended with **Teck Resources** (TCK-T, TCK-N), where his responsibilities as senior vice-president included overseeing the exploration and development of mines in Peru, Mexico and the U.S.

In-between he founded Metall Mining — which changed its name to **Inmet Mining** (IMN-T, IEMMF-O) in 1993 — before he bought out one of the company's largest institutional shareholders, which disagreed with a decision by Zeitler and his management team to invest US$2.5 billion in the huge Antamina copper-zinc project in Peru.

"The pension fund and some of my directors felt that I had gone, well, sort of crazy," Zeitler says in a telephone interview from Chile. "You must remember that at the time, Inmet had a market capitalization of about US$1 billion . . . but what this shareholder didn't understand was that it wasn't a payment of US$2.5 billion, it was a commitment to invest US$2.5 billion."

"I knew that Antamina would be one of the most outstanding mines in the world," he continues. "And so I said: 'Look, forget about it. If the board is not able to convince this shareholder that this is a good move, then I'm out of here.' So I left and joined Teck."

During his first meeting at Teck, Zeitler recalls, he asked then-president and CEO Norman Keevil, now Teck's chairman, why Teck hadn't participated in the public tender for Antamina. Zeitler reports he says: "Probably because my people were sleeping."

In 1998 Inmet sold Antamina to Teck, Rio Algom and Noranda for US$70 million in cash and a 3.33% net proceeds royalty. Today Teck holds a 22.5% stake in the mine, **BHP Billiton** (BHP-N), 33.75%; **Xstrata** (XTA-L, XSRAF-O), 33.75%; and **Mitsubishi**, 10%. In 2012, Antamina produced 446,800 tonnes copper and 12.1 million lb. molydenum on a 100% basis.

During his time at the Vancouver-based diversified miner, one of Zeitler's responsibilities was to see whether Chile's state-owned copper giant Codelco would be interested in setting up a pilot plant using Teck's CESL hydrometallurgical process, which Cominco had come up with, and involved producing copper and nickel cathode from concentrates. (The closed-loop process produces no liquid effluents or sulphur dioxide, with the only solids produced being gypsum and a leach residue that can be disposed of with associated mill tailings.)

In the end, Teck couldn't sign a deal with Codelco to use the technology — a deal was struck with **Vale** (VALE-N) instead — but the meetings with Codelco brought Zeitler into close contact with some of the Chilean company's top management, which would help years later.

In 2002, Zeitler retired from Teck, but that wasn't the end of his career in the industry. A year later he learned that Minera Valle Central (MVC) — a company set-up by former members of Codelco and backed by a major Chilean private construction group — was for sale.

MVC was set-up in 1990 to extract copper and moly from tailings discharged from El Teniente, Codelco's gargantuan underground copper mine in the Andes. Between 1992 and 1996, MVC was turning a profit, Zeitler says. But that changed in 1997 when the copper price fell to an average of US67¢ per lb.

MVC's largest shareholder suddenly found himself in straightened circumstances, Zeitler says, because he owed money to the bank for a real-estate development, and when the real-estate market soured around the same time, the bank got nervous and called in the loan.

That's when Zeitler stepped in. It was 2003, and he was convinced that the copper price had to go up eventually. "I didn't know if it would rise in a month, a year or in two years, but I knew that it had to rise," he recalls. "It wasn't just a gut feeling. I had been in the business for forty years, and at that time, the copper price had been low for five years already, which in history happens only rarely."

"Copper is always up and down, but in the past copper prices would be down for one or two years, and then they would go up again, and then come down again for one or two years," he continues. "There

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A hydraulic monitor moves old tailings material at Amerigo Resources' MVC processing operation in Chile.

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Klaus Zeitler, president and CEO of Amerigo Resources, at the MVC tailings project in Chile.

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were seldom periods where the copper price would stay down for five years, and so it was clear to me that it couldn't last much longer."

In the end Zeitler was right. A month after he bought MVC for US$23 million, the copper price climbed again. Zeitler then injected the MVC assets into a junior exploration company with properties in Ontario called **Amerigo Resources** (ARG-T).

Last year Amerigo produced 51.7 million lb. copper and 1.06 million lb. moly from El Teniente tailings at the company's operations near Rancagua, Chile. About 50% of Amerigo's production comes from fresh tailings that come out of the mine's concentrator each day (about 130,000 to 140,000 tonnes a day), and the remaining 50% come from the 3.68 sq. km Colihues tailings pond, 1 km south of Amerigo's plant.

"You can imagine how many tailings there are since they started production in 1904," Zeitler says. "They have been producing for over one-hundred years, and they will be in production, probably, for another fifty to one-hundred years. It is, in my view, the largest ever discovered copper orebody in the world, if you consider past production plus future resources and reserves."

Amerigo is in talks with Codelco to extend its agreement to the company's other tailings ponds, including the Cauquenes tailings deposit, which contains an estimated 500 million tonnes of higher-grade tailings and sits adjacent to Colihues. "Their board has already agreed to do the agreement, it's just a matter of agreeing on the terms," Zeitler says.

Amerigo pays royalties to Codelco based on the amount of copper it produces, and at what price. Last year royalties added up to US$43 million, Zeitler says.

In 2012 Codelco paid a dividend of 4¢ per share to shareholders of record — or about 6% to 7% of the company's 70¢ share price on the Toronto Stock Exchange.

"It's certainly one of the highest percentages for a dividend in the mining industry," he says. "That's more than what you get from a bank."

Zeitler says Amerigo started paying dividends soon after it was set-up, and only halted them for two years during the height of the global financial crisis. The company has been cash-flow positive every year since it started operations, he adds. In 2011, Amerigo posted a net profit of $8.7 million on revenue of $166.1 million, down from a net profit of $13.1 million on revenue of $152.1 million in 2010.

In 2013 Zeitler believes copper production will total 45 million to 50 million lb., along with 1 million lb. moly, and anticipates lower cash costs due to contract changes with Amerigo's power provider. The amended power contract, which kicked in on Jan. 1, 2013, will contribute to net savings of US40¢ per lb. copper, Zeitler anticipates, which will improve the company's cash flow.

Amerigo will release full-year financial results for 2012 on Feb. 27. For the three months ended Sept. 30, 2012, however, the company posted a gross loss of $2.05 million, compared to a gross profit of $3.14 million in the third quarter of 2011. The company's cost of sales were 19% higher in the third quarter year-on-year at $46.28 million.

The third-quarter results were adversely affected by a one-time charge for a $4.6-million bonus payment to the company's Chilean workers on the signing of a new four-year union agreement and a $2.3-million deferred future income tax non-cash accounting charge, following an increase in Chile's corporate tax rate to 20%.

Cash costs this year — the aggregate of smelting, refining and other charges, production costs net of moly-related net benefits, administration and transportation costs — before the El Teniente royalty should come in at between US$1.95 per lb. and US$2.15 per lb. copper, Zeitler says.

"This year will be a pivotal year for the company, with significantly lower operating costs and replacement capital costs that we believe will reduce the company's cash outlays by up to $35 million, compared to 2012," he says. "We are also proceeding with optimization studies, permitting and engineering, and financing discussions for the Cauquenes project, which will extend our operations in Chile by decades."

At press time, Amerigo was trading at 65¢ per share within a 52-week range of 51¢ to 95¢. The junior has 172 million shares outstanding.

Raymond Goldie of Salman Partners has a target price on the stock of 80¢ per share.