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Gold rush

Tony Makuch Is On A Mission: To Put Lake Shore Gold On The World Stage. He's Already Turned The Burgeoning Junior Into A Major Player In Timmins, Ont. Now Comes The Hard Part

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Tony Makuch, CEO of Lake Shore Gold Corp., has spent his entire career either working in mines or running them. As a result, he understands how they operate as well as anyone. If you were looking for someone to manage your mine, you wouldn't think twice about hiring him. At least, you wouldn't have thought twice in the past. Canada has a rich mining history, and its CEO ranks were once been populated by people just like Makuch -- guys who like to work underground and don't feel right without a rock in their hands to study. Today, however, large-cap mining companies

are dominated by financial wizards who are adept at spinning boardroom deals and charming shareholders, but would be utterly lost if they had to operate a mine. Guys like former investment bankers Peter Marrone of Yamana Gold Inc. and Roger Agnelli of Vale SA, who have taken advantage of strong commodity prices and built huge mining conglomerates through mergers and acquisitions in amazingly short periods of time. They look great in suits. Investors hang on their every word. And they get results.

Makuch doesn't fit in with these guys, at least as far as image is concerned. He doesn't have a perfect part in his hair. He wears braces. He stutters a bit when he's excited about something. And lately, he's had good reason to stutter. Lake Shore (TSX: LSG) is proving that great mining companies are not just built in boardrooms. They can still be built the old-fashioned way: by finding new deposits in old mining camps and bringing them into production.

In the past eight years, Lake Shore has single-handedly revitalized the gold mining industry in Timmins, Ont., finding gold seemingly everywhere it looks, even in places others have already explored. In a few short years, the company has gone from being a penny stock to having a market cap well in excess of \$1 billion. To get there, Makuch has successfully navigated an ill-timed credit crisis, takeover speculation involving Lake Shore's largest investor, and a ridiculously hot gold market. And if everything goes as planned, he hopes to eventually imitate some of those flashier CEOs and make the deals that will help create Canada's next great mining company.

It won't be easy. Makuch still needs to prove that he can build the big gold mining complex in Timmins he says he will build. Lake Shore has invested more than \$300 million in the region, and investors will be sorely disappointed if Makuch does not deliver on his aggressive production targets in the months and years ahead. Lake Shore, which is not even in commercial production yet, expects to annually churn out 350,000 ounces from its three Timmins properties by 2013, enough to make it a significant mid-cap player in the global gold sector.

"We've talked about how companies like Kinross Gold and Agnico-Eagle Mines developed from their roots in Canada and we feel we can do the same things," he says. "We're slowly proving that we've got something special in Timmins."

Makuch, 51, ought to know. He was born in Timmins and his resume is dotted with stints as a miner in and around town. He started working in the local gold and base metal mines as a university student. After earning an engineering degree at the University of Waterloo, he worked at two other legendary Ontario gold camps, Kirkland Lake and Red Lake, before joining Kinross back in Timmins. Then came stints in Nevada and Red Lake, as a senior mine manager at Dynatec, and Sudbury as chief operating officer of FNX Mining Company Inc. In January 2008, he was back in Timmins to take over the reins at Lake Shore.

Thanks to Lake Shore, his hometown was enjoying its biggest gold prospecting boom in decades. Gold was first discovered in Timmins in 1909, and the result was one of history's great gold rushes and the establishment of a classic mining town. Timmins has since produced around 68 million ounces of gold. By comparison, the more famous Klondike gold rush dug out only 12 million ounces. "If Pierre Berton had written about the Timmins gold rush, it might have been that famous too," says Tom Laughren, Timmins' mayor.

But in the last couple of decades, the action has slowed. The Bre-X scandal and the collapse of gold prices in the 1990s brought exploration to a virtual halt. Even when gold turned around and began what continues to be a spectacular bull market, Timmins did not get a lot of attention. Big new discoveries were few and far between, and geologists concluded that its best days were in the past.

It turns out that the only thing needed was a new perspective, something Lake Shore has provided. The company's predecessor, Aurora Platinum Corp., had access to an old Inco database with 50 years of drill results on the legendary Abitibi Greenstone Belt, which runs through Quebec and Ontario. One area of interest was the part of Timmins west of the Mattogami River, which cuts through town in a lazy north-south trajectory. Incredibly, that area had never been thoroughly checked in 101 years of exploration, because gold wasn't visible on the surface like it was on the east side. "The theory of the west end of Timmins extending the Timmins camp was always there, but nobody was able to put the picture together," Makuch says. "A lot of these old mining camps aren't mined out, they just need to be re-looked at."

Lake Shore was spun out of Aurora in 2002 and started drilling the west end of town. Before long, it got results. In 2004, the company hit high-grade gold on its Timmins West deposit, the first discovery of any significance on the west side. The result was a brand new mini-gold rush as exploration companies poured back into town in search of new riches. The boom was a welcome development for Timmins, population 45,000, which is losing jobs because Xstrata is closing the long-running Kidd Creek mine. As Xstrata lays people off, Lake Shore is looking to hire. "When you look at what Lake Shore is doing and what the price of gold is, it gives people in the community a lot of hope from a jobs perspective," Laughren says.

While Lake Shore was looking at Timmins in a fresh way, Makuch was doing the same thing in Sudbury with FNX (which eventually bought Aurora Platinum). Instead of searching for the big nickel deposits that put Sudbury on the map, FNX went looking for so-called "footwall" deposits, which are full of

copper and precious metals. It found several, which has revitalized Sudbury much the same way Lake

Shore revived Timmins. "When we set up the Sudbury joint venture between FNX and Dynatec and did a site visit, a guy from Inco looked at me and said, 'You're wasting your time. We checked it out and it's all mined out,'" Makuch says. "And look what happened: We built a \$3-billion company from nothing."

Lake Shore spent several years drilling out the Timmins West deposit, and eventually reached the stage where it was ready to transition from being an explorer into a mine developer. But it needed a CEO with operating experience and Makuch fit the bill perfectly. He had years of experience running mines in Northern Ontario and was also a member of Lake Shore's board (a result of the FNX-Aurora connection).

Makuch was named CEO right in the middle of a tumultuous time for Lake Shore. In order to build its mine and have enough money going forward, the company needed to raise about \$200 million, a sum equal to its market cap at the time. Needless to say, early 2008 was the wrong time to be trying to do that. The credit crunch was well underway, and the banks, panicking about their own balance sheets, had no interest in financing junior mining companies. The big Bay Street gold companies weren't any help either. They still shared the widely-held view that there was not much left in Timmins and Lake Shore's discovery was nothing special. They would learn to regret their decision once Lake Shore found even more gold.

While most junior mining companies at that time were far more concerned about protecting their cash than actually mining anything, Lake Shore was determined to raise the necessary money. In the end, it had to go all the way to Peru before it found a company, Hochschild Mining PL, willing to give it financing. The two miners formed a strategic alliance, and Hochschild now owns 36% of Lake Shore. "They understood that there was a lot of value to be created here," Makuch says. "We were a \$200-million company. Today, we're a \$1.2-billion company. What we needed was the financial resources to get from there to here."

Meanwhile, Lake Shore was hunting for more gold on the west side of Timmins. It soon became clear that the company had another major find at its Thunder Creek deposit, less than a kilometre away from the Timmins West discovery. In 2009, the company started hitting gold intercepts at Thunder Creek that rivaled anything ever seen in Timmins. And Lake Shore was still not done. Back in 2007, the company bought the Bell Creek mining complex from Kinross and Goldcorp for \$10 million. The main appeal of this property was the mill, which Lake Shore wanted in order to process ore from Timmins West. But Lake Shore also drilled deeper at Bell Creek than its previous owners had, and it found more gold than anyone thought was there.

In between all the exploration success, Makuch proved he could also play the boardroom game. Last fall, he pulled off the company's most significant transaction to date: a \$424-million all-stock takeover of West Timmins Mining Inc., its joint-venture partner at Thunder Creek. That gave Lake Shore full control of its most promising discovery.

Today, the company is more active than ever in Timmins. Mine construction at Timmins West (renamed the Timmins Mine) is largely complete: a shaft has been sunk and mining the deposit has begun. The project is expected to go into commercial production later this year. Lake Shore is also digging a tunnel underground to connect the mine to the nearby Thunder Creek discovery.

All this work has put Lake Shore in a highly unusual position: a chance to build a great Canadian gold mining company, and to do it using core assets that are actually in Canada. The company is not producing positive cash flow yet, but its targets are aggressive. Eventually, it hopes to raise production

to one million ounces, a significant addition to the 90 million ounces already produced worldwide every year.

Makuch is not one to downplay expectations. As far as he is concerned, this is just the start. He hopes to use the three Timmins projects as a base to expand around the world by buying or merging with other companies. It's a highly unusual strategy in the junior mining world, where most CEOs try to sell out to the highest bidder as soon as they find something interesting.

But Lake Shore's aggressive production plans have investors feeling a bit tense. During the glory days when the company was hitting high-grade gold on a regular basis at Thunder Creek, Lake Shore's stock moved in an upward parabolic trajectory that easily outperformed the price of gold. There is a reason, however, that few junior mining companies try and construct mines: It is extremely tough to build them on time and on budget. Delays and massive cost over-runs have become the norm in the industry.

As investor's initial euphoria over Lake Shore's finds wore off and they realized there was a lot of hard work ahead, the company's stock started sinking from its high of more than \$4 a share last November. On March 10, investors got another reminder of the challenges to come when the company cut its production guidance for 2010 to 65,000 ounces of gold from 100,000 ounces. Lake Shore explained that it changed its estimate because of the need to develop the promising Thunder Creek and Bell Creek mines. But the cut just further highlighted the fact that its production targets are not easy to reach.

"I'd say they have a fairly aggressive timetable," says Wendell Zerb, an analyst at Canaccord Adams. "Tony and his team are very good operators, but these are projects that often take some time before you get them to steady-state production. And there's a lot of moving parts going on with this particular company."

Adding to the uncertainty is the question of what Hochschild will do with its interest in Lake Shore. The two companies have a standstill agreement which restricts Hochschild from owning more than 40% of Lake Shore until Nov. 22 of this year. After that, it can

buy as much as it wants, and there is speculation it will look to buy it all. When Lake Shore has issued stock in the past, Hochschild has repeatedly invested more money in Lake Shore to avoid diluting its stake.

If Hochschild or another buyer decides to take a run at Lake Shore, Makuch will be stuck in the same position as Inco, Falconbridge and so many other Canadian mining companies before. Like them, he'll have only one course of action: run an auction and try to get the best possible price. Makuch is perfectly willing to do that, but it's also the last thing on his mind. After spending the past two years and a lot of money to build Lake Shore into a serious mining company, he wants to see it go further. "If we can demonstrate to our shareholders that they will see better upside with us, then they'll stick with us," he says.

Spoken like a true mining exec. He has clearly picked up a thing or two while watching some of his more finance-oriented CEO colleagues at work. Without knowing it, they taught him how to tell the Lake Shore story to investors. And the Hochschild and West Timmins Mining transactions prove that Makuch can navigate his way through the capital markets like a veteran dealmaker.

But he has no illusions about what he is: a mining guy through and through. Whatever happens with Lake Shore, he will always be tied closer to the rocks of Northern Ontario than the corner office in

downtown Toronto where he now toils. "What do I want to do 10 years from now? Work in the mining industry," he says. "What do I want my kids and my grandkids to do? Work in the mining industry."

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