

An explosive gold stock for 2008

Introduction

Gold has surged in 2007 on the back of the US dollar hitting all time lows. With the US dollar weak and looking to go lower, gold should perform very well in 2008 and may even print over \$1000/ounce. For the most part, senior gold producer stocks have been the beneficiaries of gold's move. Usually, majors begin to move then mid-tier, juniors and then finally explorer gold stocks rise. It is the smaller stocks that see the largest gains in excess of hundreds of percent. 2008 may prove to be a very exciting year for precious metal stock investors.

Finding the right small cap stock to take advantage of the gold bull market is the tricky part. What an investor needs is to find a miner who is rapidly growing production as gold continues to rise. Many gold producers have flat to incrementally rising output. There is one severely undervalued gold miner that has bucked that trend with quarterly production this year of 42,000 in Q2, 70,700 in Q3 and will likely produce 100,000 in Q4. The company should continue to increase production during 2008 until Q4 when their annual production rate should be on the order of 600,000 ounces.

500,000 ounce producer survey

The precious metals sector has a few gold producers with annual output around 500,000 ounces. The table below is a survey of three miners with estimated gold output for 2008. All three companies have been producers for years and have roughly the same reserves and resources. Centerra (CG.TO) and Randgold Resources (GOLD) have market valuations typical for the gold industry around \$200 per gold ounce of resources. However, Golden Star Resources (GSS, GSC.TO) is significantly undervalued valued only \$60 per resource ounce. They are rapidly increasing quarterly production but you wouldn't know it by their market cap.

	Centerra	Randgold	Golden Star
Stock Symbol	Toronto: CG	Nasdaq: GOLD	Amex: GSS
Reserves (M oz)	7.0	6.3	7.0
Resources (M oz)	8.4	12.5	12.0
2008 Production (oz)*	550,000	450,000	550,000
2008 Cash Cost*	\$450/oz	\$350/oz	\$450/oz
Shares Outstanding	216 M	75 M	234 M
Market Cap (\$)	2,455 M	2,633 M	724 M
Market Cap/Resource oz	\$292/oz	\$210/oz	\$60/oz

*Derived from presentations and press releases.

Why is Golden Star so cheap?

There are several contributing reasons for Golden Star's share price being cheap but none to explain why their stock is as low as it is in its peer group. Back in 2003, Golden Star was the market darling of the gold sector. GSS exploded four

fold in under a year and reached its all-time high around \$8.50. At the time, GSS continued to report upside surprises each quarter as gold surged to multi-year highs. Right around the corner was the expected production boost from their newly developed Wassa mine spring 2004.

Entering 2004, investors were expecting good things from the company then news emerged that the Wassa mine was not on schedule and would not be brought to full production as guided earlier. Delays in production of a new mine are not uncommon in the mining sector so there was some sell side pressure but investors were still bullish on the stock. Then in late spring, management decided to make a hostile bid for IAMGold. Hostile bids in the gold sector are not met kindly by the market and Golden Star's share price was punished. If their failed hostile bid wasn't enough, GSS came out with extremely disappointing earnings in late 2004 without warning the market. You can see how GSS went from market darling in 2003 to market pariah in 2005 in the following chart.

Figure 1: Golden Star 5 year stock performance.



While gold continued to rise in years 2005 and 2006, GSS continued to underperform the HUI and its peers. Golden Star from late 2004 through early 2007 disappointed the market with every quarterly release. Management continually missed guidance, Wassa the promise of 2004 lagged projected output with high cash costs and the stock became the playground for short sellers. The market would have been more kind to the stock but their management team made a habit of grossly over-promising production guidance, reaffirming that guidance at public gold conferences then a few weeks later significantly lowering projections when earnings were released.

Golden Star's lack of performance was not lost by short sellers. Several writers in 2005 and 2006 noted that GSS had a disproportionate level of short interest against the stock. GSS in those years made shorts millions of dollars and left investors with a bad taste in their mouth after sustaining heavy losses.

Early this year investors began to warm up to GSS and for the first four months of 2007 it was the best performing gold stock in the HUI. The grip the shorts had on the stock was waning with short interest contracting during the period. The reason for this early surge was a large number of warrants expired in February and their Bogosso expansion project was meeting projections. Expiring warrants are almost always positive for a stock as warrant holders no longer have a fixed price to cover their shorts. Everything was going well until April when the company announced there were mechanical problems at the Bogosso project and production targets would be delayed by a couple of quarters. That news was music to the ears of the shorts who fed so well with the stock over the last two years. All they needed was another guidance miss to bring back a Pavlovian response by investors to pull in their bull horns.

Figure 2: Golden Star H1 2007 stock performance



Since May, GSS stock performance has been dismal with the share price hovering above 52 week lows while gold remains around \$800. Unlike at earlier times, the share price has now significantly deviated from fundamentals. GSS has announced that their CEO is leaving and raised funds via a convertible offering over the last six months. While anytime a CEO is leaving or capital is raised it's usually stock negative but not to the degree of the GSS share price. For many long time investors, the outgoing CEO is seen as a big positive saying any warm body would have better management skills. The convertible offering was actually on terms far more favorable than those Citibank received recently.

The reason the Author believes Golden Star's share price is low is due to the presence of predatory short selling by a single group or groups. GSS trading behavior for several months has been non-intuitive. When the HUI explodes to the upside, GSS initially rises in the morning and then is sold off late in the day remaining up slightly or unchanged. GSS will firm up and fall less when the HUI has a substantial loss. Several market observers have noted that a trader on the TSX "Anonymous" supplies as much as 80% of the sell volume on up days and nearly the same amount of buy volume on down days. Others have observed how Anonymous walks the share price down with small 100 share lots. It is highly likely this trader(s) is working the Amex in a similar fashion. Golden Star has enormous call open interest in January. Anonymous may also be responsible for writing many of those calls. A perennial short position goes a long way in ensuring a written call position is protected so they expire worthless.

Why Golden Star should outperform the sector in 2008?

Golden Star's past, along with the help of suspected predatory short selling has placed its share price where it is today. Against peers, it is under valued not by a mere few percentage points but by a factor of three or more. Management has continually missed guidance but 2007 has brought guidance much more in line than the past. Their flagship Bogosso expansion project has been pushed back early in the year but is now performing very close to design. Quarterly production is exploding and in their most recent conference call with investors GSS said throughput was at design specifications and gold recoveries were almost at design. For reference, GSS produced 70,700 ounces in Q3 with Bogosso recoveries at 40%. In the early November conference call, recoveries were double at 80%; near design.

Along with Bogosso nearing full production capacity, other positives are now being realized. Ghana for well over a year had placed power rationing on gold producers. Golden Star had to produce a large amount of electricity for their operations with expensive diesel fuel generators. Now after a series of rains have come back to the country, Ghana announced as of October 1st that power rationing has ended. GSS has also broken ground on a 50 km road to their gold rich ore at Benso. They expect to finish the road and begin hauling high grade ore from Benso to Wassa processing facilities by Q3, 2008. Considering Benso's ore is about 4 times richer than Wassa, output will increase and cash costs will decrease.

Presently the market is punishing GSS for its past and has not begun to reward the company for its future. As a precious metals investor, this is precisely what one looks for: an undervalued producer, rapidly growing production with its stock trading at depressed levels. One day not too far in the future, investors will begin to recognize the exceptional value Golden Star presents. There is not a single junior gold company with the production and resources GSS has trading at such

depressed multiples. 2008 is likely going to be a year where Golden Star recaptures its 2003 magic and finally flushes out short sellers like “Anonymous”.

Golden Star Resources:

- Amex – GSS, Canada - GSC
- Shares Outstanding: 234 million
- Market Capitalization: \$724 Million (US)
- Gold Mineral Resources: 12 million ounces
- Estimated 2008 Gold Production: 550,000 ounces
- Estimated 2008 Cash Flow (\$800 Gold): > \$220 million

Figure 3: Golden Star present chart.



Disclosure: The author has not been paid to write this article, nor received any other incentive to do so. The author holds a position in the company and will benefit from any increase in the company's share price. Disclaimer: The author's objective in writing this article is to promote potential investor interest in this stock to the point where they are encouraged to conduct their own research, verify the information presented and make their own conclusions. Neither the information, nor the opinions expressed should be construed as a solicitation to buy or sell this stock. Investors are recommended to obtain the advice of a qualified investment advisor before entering into any positions in the stock.