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HudBay bets big with Constancia project as rivals pull back

By PAV JORDAN

Copper project in Peru will cost mining company nearly as much to build as its entire market capitalization

Toronto-based HudBay Minerals Inc. is a rare breed these days.

In an industry reluctant to spend on anything beyond operating costs, the base metals miner is plowing ahead with a copper project in Peru called Constancia that will cost it nearly as much to build as the company's entire market capitalization.

Even as global miners report billion-dollar cost overruns and asset writedowns and the industry is buffeted by demand headwinds in commodity markets – HudBay is spending \$75-million a month on Constancia, where thousands of workers are already on site.

"It's a relatively small company with a big project in development in Constancia and that's got the market a little bit concerned," said John Hughes, an analyst with Desjardins Securities in Toronto, who nevertheless has a "buy" on the stock and a target price that is 30 per cent higher than where it's currently trading.

Others share not only his concerns, but also his enthusiasm about potential growth at the company, and 80 per cent of analysts polled by Bloomberg News have a "buy" rating on HudBay, which closed at \$10.12 a share on Thursday.

"They're basically betting their market cap on one mine," said George Topping, an analyst with Stifel Nicolaus in Toronto, who also has a "buy" on the stock, with a target price of \$13.75 a share.

In fact, the \$1.5-billion Constancia project is one of three put into development by HudBay since it hired a new chief executive officer in 2010, just as investors bet it was ripe for takeover, with bulging balance sheets and no growth plans.

Constancia and two projects in Canada, Lalor and Reed in Manitoba, will contribute to a fivefold increase in HudBay's copper production within two years. Gold production will double in the same period and zinc output will grow by a third.

"We've come a long way from a company that was really just harvesting its operations in northern Manitoba," said CEO David Garofalo.

"When I started in this job in July, 2010 ... it was a company that was gradually dying, because it wasn't replacing what it was pulling out of the ground."

One of his first moves was to put Lalor, a \$794-million, gold, zinc and copper resource discovery, into development in Manitoba, where it has mined the Flin Flon Greenstone Belt for 85 years. Reed, located in the same belt, is a \$72-million underground copper mine being built by HudBay and VMS Ventures Inc.

After joining the company, Mr. Garofalo sat down with management to review opportunities in countries including Canada, the United States, Mexico, Chile, Peru, Brazil and Colombia.

In a move that would be rare in today's markets, HudBay started taking stakes in junior miners, including Constancia's then-owner Norsemont, and Augusta Resource Corp., which could become another development opportunity.

"We decided we would be the partner of choice to juniors because we decided that was where we were going to source our growth opportunities," Mr. Garofalo said from offices overlooking the Air Canada Centre in Toronto.

"We started putting capital to work at juniors, \$3-, \$4-, \$5-million here and there, and we built up a portfolio of about eight juniors, many of which we still own."

HudBay already has over 2,000 people on the site at Constancia, located in the southeastern Andes mountain range. It is taking delivery on machinery and pouring concrete, and plans to start taking delivery of mills in coming months.

At the same time, billion-dollar projects have been cancelled elsewhere in Peru and across the border in neighbouring Chile, ironically lowering costs for HudBay.

Constancia became fully financed over the course of the last year as HudBay sold future silver production from the mine to Silver Wheaton Corp. for a cash injection of \$750-million (U.S.), arranged a \$600-million credit facility from a syndicate of Canadian and international banks and a \$500-million bond issue.

Analysts and investors say they would like to see the company sell a stake in Constancia to share the risk of the mine, which will start up in 2014, with production of some 100,000 tonnes per year of copper in concentrate.

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