Putting the "Star" Back in Golden Star Resources

By Adrian Douglas

Many café members who are stockholders of GSS have been extremely frustrated with the performance of the company over the last 2 years. Golden Star lived up to its name and put in a "stellar" performance rising from around $0.2 per share to $8 from 2001 to 2003. Since then it has fallen to around $3.14 per share today.

The fundamental story of Golden Star Resources is truly an exciting story and the company has great potential. Unfortunately the management has made many mistakes that have made investors focus on the hole and not on the donut.

The Growth Story

Billiton mining was the owner and developer of the present mine at Bogoso in Ghana. The property has oxide gold ores near surface which are easily mined and processed. The property has much more resources at depth but these are refractory sulfides. Refractory sulfides need to be treated either with very high heat, high pressure or bacteria (bioxidation or bug leaching). Billiton chose the heat method and failed. They were consequently in a bind because the oxides were being depleted with their mining. Billiton became Gencor which walked away from Bogoso when their lenders wouldn't work with them on the necessary changes needed, and the bankers sold the property to GSS for a song with only around 2 years of oxide production left. GSS subsequently acquired Prestea which is an adjacent property which gave them more oxides. They immediately had more oxides to feed the 140,000 oz oxide circuit.

Golden Star decided to opt for a Biox (bug leaching) circuit for treating the sulfides. This has been successfully implemented in the nearby Obuasi goldmine operated by Ashanti where the ore is very similar. Golden Star has successfully run a pilot circuit and can now scale up to full production scale. No one has fully proven up the refractory sulfides but GSS has over two million ounces of proven and probable refractory reserves at Bogoso and all GSS has to do is go and poke some holes in the ground to prove additional reserves.

GSS has raised production to 200,000 ozs per year and will reach 300,000 this year and 500,000 ozs per year in 2007 when the sulfide circuit is fully operational.

Investors were not happy about the St Jude acquisition but this is in close proximity of Wassa and allows ore to be trucked to Wassa for processing which will raise the average grade as St Jude ore is of higher grade. This is expected to both increase the output from and add several years to the Wassa operation. Also St Jude had a lot of properties that have good exploration potential.

GSS has tackled a project that has been very challenging and has been succeeding as can be seen from the production growth. This is a major achievement because the mining giant Billiton failed on the same project after having invested around $150 million. Golden Star has 10 million ounces of reserves and resources with a lot more that can be added as low hanging fruit and they have cracked the technological issues of how to process their ore.

All this has been very expensive and the high development costs have impacted the bottom line of GSS.

The Problems

So with such a great story why has GSS stock languished?

The main issues have been that GSS management has not done the right things to sell this story to the junior mine investors. Junior mine investors want to buy a junior miner. In many respects GSS has behaved like a Senior Miner. They tried to acquire IAMGOLD. This acquisition failed to materialize but the damage to the GSS reputation was dramatic. Many investors doubted the technical prowess of GSS to succeed where a giant like Billiton had failed. The move to acquire IAMGOLD and then St Jude was seen as a grab for reserves. The “body language” of these maneuvers said “we are running out of oxides and we probably can’t process our huge sulfides deposits. We need to make an acquisition”. Nothing could have been farther from the truth but that was the read of the market. This was not the expected behavior of a Junior Miner this was like Newmont or Anglogold who have difficulty replacing their reserves through exploration so they acquire another company instead.

Then the real killer move was when management decided to hedge some of their gold production by buying puts at around $400/oz and then raising cash to offset these by selling calls at $525/oz. This effectively meant that about 17% of their production would be sold at $525/oz until March 2007 even if the gold price was higher than that.

The market has seen GSS acquisitions as a tacit admission that the growth story wasn’t going to materialize and then hedging of their gold production meant that the upside exposure to a rising gold price had been handicapped. GSS stock was sold off. In addition, I believe from looking at the trading action, that some traders, like sharks smelling blood, have taken advantage of the poor investor sentiment to manipulate the stock lower.

Last week there was another announcement that a 53% owned subsidiary EURO Resources, which is a royalty company had to restate earnings due to a change in the accounting treatment of hedges it had made as a condition for a bank loan. In early 2005 the company had been obliged by its bankers to structure a hedge that essentially resulted in EURO Resources receiving a fixed royalty payment for its gold production. This was declared in GSS 10-Q filing but the accounting change brought it to the attention of investors.

I have for a long time been a strong proponent of Golden Star Resources. They have a great growth story, having increased production from 140Koz to 250 Koz per year and will rise to 500 Koz next year. They have solved tough ore processing problems. They have very good exploration potential.

I have been badgering GSS management, and in particular Allan Marter, to start behaving like a junior miner. Junior Mining investors want to see production growth, exploration potential, and above all a production that is UNHEDGED so that they can get full exposure to the gold price. If you can not provide these elements then investors will go elsewhere, which has been the case for GSS.

I think the production results speak for themselves and shortly it will be clear that GSS did not go on the acquisition trail because they needed more resources. But the key issue for many investors is that a junior miner must not have hedged production. Investors would much rather see equity financing than hedging. Agnico Eagle took this route. The equity financing hurt their stock at the time but their stock has been stellar in recent months.

I laid down the gauntlet to Allan Marter and said that GSS MUST state their policy on hedging and then adhere to it. Allan came back with the following:

“I think it is accurate to say that we do not intend to hedge our gold in the future – ever.” – Allan Marter CFO, Golden Star Resources, April 4, 2006

Now that is a bold statement and unequivocal. This is what I have been waiting to hear. I wanted to hear that GSS management was going to offer junior mining investors what they want to see in a company.

I do not condone the errors that GSS management have made, but because this company has such stellar potential I have written many e-mails to them to try to get them to sell their story instead of doing things that made many doubt their story.

I believe the bad news is behind GSS. I see this latest statement from Allan Marter as a realization of what the investors want from them. I am prepared to let them show us they have turned the page.

Allan Marter tells me they are investigating the trading activity in their stock and are following several investigative leads.

Finally let's look at how GSS is doing. The graph below is the price of gold divided by the stock price of GSS. While this is rising gold is outperforming GSS. When it is falling GSS is outperforming gold. You can see that since the end of 2003 gold has outperformed GSS as there is a well defined trend channel. However, just recently the 200 DMA has broken below this channel for the first time in 3 years and it looks as if the 50 DMA and the daily price are about to do likewise. It looks as if some savvy investors are also sensing that the worst news from GSS is behind us.

I believe GSS management has turned the page. They have finally understood what their shareholders want. I believe GSS can return to the constellation of high performing junior miners over the next few quarters.

I am prepared to give them the benefit of the doubt and reassess my position at the end of 2006.

Adrian Douglas

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