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Medusa ramps up low-cost Co-O mine in Philippines



MEDUSA MINING

The Agsao inclined shaft at the eastern end of Medusa Mining's Co-O gold mining complex in the Philippines.

BY JOHN CUMMING

While **Medusa Mining** (MML-A, MML-L) is focused solely on Mindanao in the southern Philippines, its Co-O mine on the island's eastern end has proven to be so bountiful that the company is rapidly transforming itself into a profitable, 100,000-oz.-per year gold producer.

Medusa has contiguous tenements covering 880 sq. km in east-central Mindanao encompassing 70 km of strike length over favourable ground.

Its wholly owned, flagship Co-O mine (pronounced "koh-oh") is situated on the west bank of the Agsao River about 140 km north of the city of Davao. The mine sits midway between two Tertiary copper-gold districts — Surigao to the north and North Davo to the south — that host significant copper and gold deposits,

including Boyongan, Siana, Diwalwal, Amacan, Masara, Kingking and Tampakan.

"The Philippines is one of the most mineralized countries in the world, probably almost equivalent to Chile per unit area, and East Mindanao, where we are, is regarded by many commentators as the most mineralized belt in Southeast Asia," says Medusa's managing director Geoffrey Davis over lunch in Toronto with finance director Roy Daniel and *The Northern Miner*. "I've seen a lot of Indonesia and most of the Philippines and I haven't seen an area that is so well structurally prepared as we've got. We have a fantastic volcanic setting combined with a lot of structural disruption — it's a very good setting for mineralization."

Davis and Daniel's partnership at Medusa has its roots in the pair teaming up to manage various Philippines assets in 1999-2000 for London-based Philippine Gold.

However, gold was out of fashion at the time and the company was under severe financial distress. The main task, therefore, was to sell off gold assets, including what is now **CGA Mining's** (CGA-T, CGX-A, CGAFF-Q) Masbate mine and the then-closed Co-O high-grade underground mine, which had started production in the late 1980s but was soon placed on care and maintenance after producing only 60,000 oz. gold.

Co-O (short for the Spanish boy's name "Consuelo" or consolation) was sold to Bill Phillips, a veteran narrow-vein gold miner from Kalgoorlie, and his Filipino

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partner Sammy Saga.

Their company, Philsaga, started sketching out plans to re-open Co-O that avoided the error of its previous operator who had unwisely tried mechanized mining on a narrow vein deposit.

Meanwhile in Perth, Western Australia, Medusa Mining was formed in early 2002 as a private company with Davis as managing director and a portfolio of six Australian properties.

But Davis felt the pull of the Philippines and in 2003 returned to do a joint venture with Philsaga that ended up being the basis of Medusa's initial public offering later that year.

The JV worked well enough that Medusa bought Philsaga in December 2006, which gave Medusa access to Co-O.

"I've always had a focus on high-grade — I've never really wanted marginal deposits, particularly when I'm running the company," Davis says. "The mine and plant complex needed some work done to rehabilitate it, but it was in pretty good nick, and had only been used eighteen months by the previous operator."

With renewed vigour, Medusa set about redeveloping the mine with an initial production target of 40,000 oz. gold per year from 240,000 oz. of defined gold resources.

But by August 2007, after considerable success with the drill bit, Medusa had tallied a new resource showing over 600,000 oz. of gold. The next month, Medusa decided to take the long view: it cut production and boosted waste development while it came up with another development plan.

Medusa then began its first phase of expansion to take Co-O to an annual production rate of 60,000 oz. gold. It sank two new production shafts — one internal and the other from surface — and started to reap the benefits of that expansion in the last three months of 2008.

For the fiscal year ended June 30, 2009,

Medusa produced 47,869 oz. gold from 116,451 tonnes of ore grading 13.3 grams gold, with a 93% recovery rate. Cash costs were US\$213 per oz. (including US\$46 per oz. for taxes and royalties) and the gold, which is refined in Hong Kong, was sold at an average price of US\$880 per oz.

"In Australia and on the AIM, that puts us as the lowest cash-cost gold producer," Davis notes with satisfaction.

In the second calendar quarter of 2009, Medusa produced 16,009 oz. gold at a cash cost of US\$198 per oz., and the company now forecasts quarterly output of 16,000 oz. and cash costs of US\$200 per oz. for the rest of this calendar year.

Compare those robust numbers to the third calendar quarter of 2008, when Co-O yielded only 6,986 oz. gold at a cash cost of US\$243 per oz.

Miners are now tapping into reserves that stood, as of August 2009, at 1.04 million tonnes grading 14.9 grams gold per tonne, for 500,000 contained oz. gold. A further 4 million tonnes of 13.3 grams lie in the indicated and inferred categories, for 1.4 million contained oz. gold.

Co-O's 1.9 million oz. of gold are hosted in more than a dozen high-grade, east-west-trending veins that have both vertical and horizontal continuity, and are open in all directions.

"It's a uniformly high-grade vein system, with no shoots," Davis says. "It's quite amazing."

The combined current haulage capacity (including waste) from several shallow, inclined shafts is now 1,100 tonnes per day, and the mill will be able to process 1,000 tonnes per day by the end of the year. The biggest upgrade at surface is the doubling of the current carbon-in-pulp plant capacity to 1,000 tonnes per day.

Currently there are five working levels (six by year-end) with 15 metres between levels, 21 working faces, and 12 stopes either completed and ready for pulling, or being developed. There are 60 air legs working and another 15 on the way.

The next big leap will be in the first

calendar quarter of 2010, when quarterly output is expected to rise to 25,000 oz. gold and cash costs to ease off to US\$195 per oz. For the fiscal year ended mid-2010, Medusa aims to produce 82,000 oz. gold, followed by 100,000 oz. the next fiscal year.

"With those six levels, we've got five or six years ahead of us without having to go deeper," Davis says. "The 100,000 ounce-per-year level is a comfortable production number without putting much stress on the mine."

Davis emphasizes that Medusa only needs to produce at a rate of 750 tonnes of ore per day with a long-term head grade of 13 to 15 grams to achieve that desired level, "so it's not a big materials-handling exercise. And sixty to seventy percent of our costs are fixed, so as the ounces go up, the cash costs come down."

Medusa obtained a key 25-year, renewable mining lease at Co-O in fiscal 2008, and the company now has some 1,500 people working at the mine site, virtually all of whom are Filipinos except for five expats.

Philsaga remains the operating company in the Philippines, as Medusa — a foreign entity — is not registered and does not have a corporate presence in the country.

"We keep it low profile," Daniel says. "Why create something we don't need to?"

Socially at Co-O, Medusa inherited many successful community projects from Philsaga that it continues to support, such as scholarships and adopt-a-school programs, the funding of a 16-bed hospital with a doctor, micro-loans to rice farmers, and water and forestry programs.

Another factor that helps bring the locals on side is that much of the fabrication work related to the mine is designed and carried out locally, which also substantially reduces costs.

But Co-O is as much an exploration story as it is a production one.

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In December 2008, Medusa announced the discovery of a new high-grade vein at Co-O named Great Hamish, which had an average grade and width in 12 holes of 61 grams gold over 2.3 metres wide.

This news helped decisively reverse a declining stock price, and the vein was incorporated into a new 1.2-million-oz. resource estimate in January.

Broadly, Medusa's objective at Co-O is to maintain 100,000-oz. annual production from veins in the known strike length using the shafts that are in place, so that as the company increases the strike length of the gold veins at shallow depth, more shafts can be sunk and production levels raised again.

To that end, Medusa has six surface rigs working on the main vein system and its extensions, and another three on satellite veins. Plus, three rigs are busy underground.

Medusa's exploration budget for this year is a healthy US\$14 million, with an average of 7,500 metres of core being drilled a month, and holes on average 500-700 metres deep.

"We are now looking at the possibility of a next phase of expansion which would bring us up to 200,000 oz. per year," Daniel says. "As the thing grows, you just have to look forward."

Bananghilig gold

Situated a 30-km drive north from the Co-O plant at the northern end of the 18-km, gold-copper-mineralized Barobo fault corridor lies Medusa's second-most advanced asset: the Bananghilig deposit.

Bananghilig is found within a small caldera and is characterized as a diatreme breccia. It has so far been defined along 850 metres length, 550 metres depth and 100-150 metres width, and it hosts 15 million inferred tonnes grading 1.3 grams gold per tonne, for 650,000 contained oz. gold.

Some of the better drill results at Bananghilig include 206 metres of 2.42 grams gold, 182 metres of 2.13 grams gold

and 117 metres of 3.96 grams gold.

"It will be campaign drilled towards the latter half of next year, and we expect it to get well over one million ounces without too much trouble," Davis says. "We'd be looking at a major new milling facility in the northern part of our tenements in a couple of years."

Medusa also has six porphyry copper-gold targets on its tenements, with drilling ongoing with three rigs at its Lingig copper prospect and completed at its Kamarangan copper target.

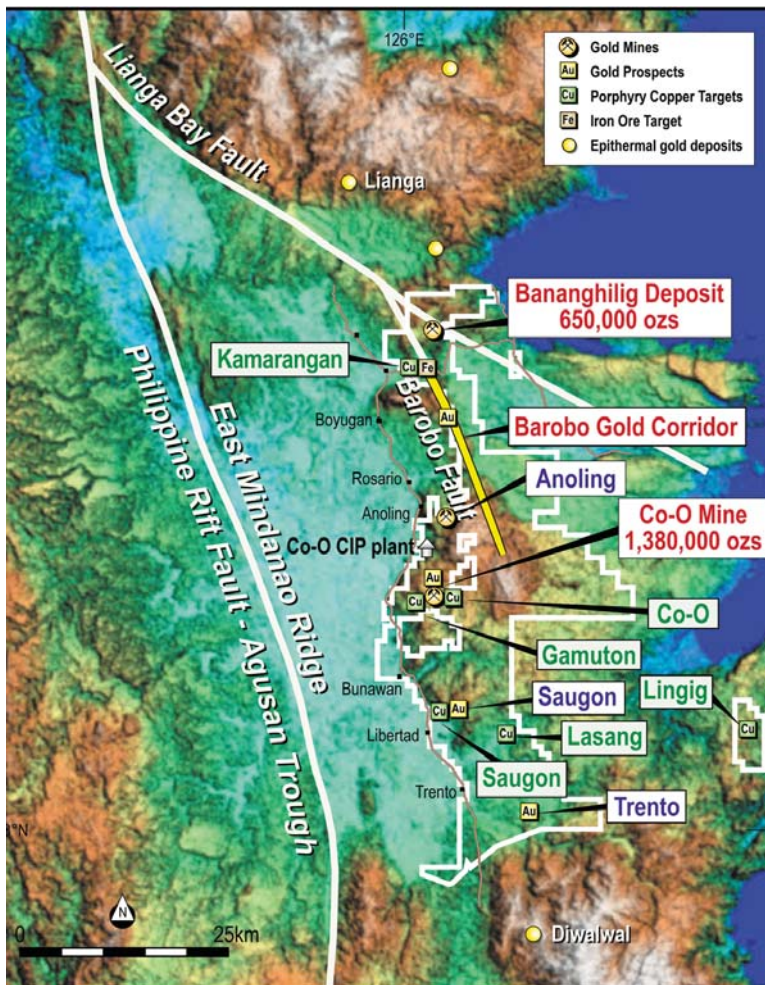
Lingig displays thrust-hosted porphyry copper mineralization with a potential for the discovery of a large mineralized body.

One of the better holes, LIN-3, cut 224 metres grading 0.77% copper and 0.11 gram gold per tonne.

"The plan is to drill up value, drill up a resource of 300-400 million tonnes or whatever and then sell off fifty to sixty percent to a major and put the money back into the company," Davis muses. "And do it early rather than wait for the ultimate production scenario."

"If we hit the big kahuna there, the big porphyry, then all hell will break loose. And if we don't, it looks like we'll be drilling pretty good grades in the thrust belt."

Regarding the separatist Muslim Abu



A map of Medusa Mining's projects in eastern Mindanao, the Philippines.

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Sayyaf guerillas in the southern Philippines, Davis describes them as being more in the southwestern archipelago and not in the region where Medusa is active. "On our side of the island it's all Christian, so we don't have those sorts of problems," he says.

As an example of the concern, as recently as Aug. 12 there was a clash on Basilan island, some 500 km west of Co-O, where 23 Philippines soldiers and 31 Abu Sayyaf and Moro Islamic Liberation Front (MILF) rebels were killed.

As for any possible acquisitions in the Philippines outside of Mindanao, Daniel is hesitant: "It's enough (to stay in Mindanao). Even if we were offered projects elsewhere, we wouldn't do it. To

operate in another province of the Philippines is like operating in another country."

Daniel's equanimity is helped by the company's strong finances: it is debt-free, unhedged and sitting on A\$33 million in cash.

As for initiating a dividend, Davis says management has to "secure the company's position before we start considering one."

Medusa has 168.7 million shares outstanding, or 172 million fully diluted. While the stock was below A75¢ at the start of the year, shares last traded at A\$2.62, giving the company a A\$442-million (US\$365 million) market cap.

Currently Medusa's biggest share-

holders are: directors and management, 15.7%; British investor Rex Harbour, 11.3%; Russia's Metalloinvest Holdings, 8.8%; two Filipino vendors of Co-O using the name Advanced Concept, 8.8%; and Canada's Sprott Asset Management, 5.4%.

Apart from visiting shareholder Sprott, one of the reasons Davis and Daniel are in Toronto is to feel out the appetite for a Canadian or U.S. listing for Medusa.

"We've got to the stage where our production is pretty consistent and we're where we want to be," Daniel comments. "We've de-risked the project, we've got cash flow, we've got blue sky and now's the time to come to Canada, to North America."