



Emerging Trends Report

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2010-11 Australian Precious & Specialty Metal Project Survey

Investment Report #2/May 31, 2010: ***Morning Star Gold NL*** (ASX: MCO)

Mineral Focus: gold (*please refer to page 31 for Gold Market Drivers*)

Why We Bought Morning Star Gold:

1. In this threatening investment climate, *we prefer the inherent flexibility and cost controls attendant to a high grade, low through-put gold mining operation to a large open cut project that relies on the economies of scale for success* because we view the former as the more defensive and defensible of the two approaches.
2. We are finding that where too many Australian mining companies have too many multi-metallic prospects spread far and wide across the island continent but too little capital to develop them ***Morning Star Gold***, under the guidance of Managing Director and largest shareholder Nick Garling, *has but one focus, high grade reef gold in the Woods Point Dyke Swarm, and the money both to develop what they've got in their namesake mine as well as that in other historic mines in the area.*
3. The successful completion of its March 2010 option-share conversion puts ***MCO in a cashed-up (+/- A\$7.5 million), no-debt position, including an essentially paid for A\$3.5 million, 80,000 ton per annum (tpa) Gekko onsite gravity plant*** (final payments attached to production benchmarks) that will enable the recovery more than 90% of the free milling gold without chemical processing.
4. Morning Star Gold (MCO) has spent \$25 million de-watering, renovating, and reclaiming the historic Morning Star Mine, which it put back into production in November 2009: ***roughly 10,000 tons of ore are currently stockpiled and awaiting treatment by the new mill***, which will be installed and is anticipated to be put into production by August 2010, and ***with the pouring of its first gold the company will undergo a substantial equity re-rating from mine developer to gold producer.***
5. MCO plans to process 30,000 tons of ore grading 12 g/t through the end of this fiscal year and 50,000 tpa at 15 g/t for 2011 at an ***all-in production cost of between A\$600 and A\$650 oz*** (US \$520-560 oz at current exchange rates); as discussed below, this estimate is historically conservative and will prove to be, we believe, a refreshing case of under-promising and over-delivering.

6. Over its 102-yr production history, it is estimated the Morning Star Mine produced 883,000 oz of gold at an average grade of 27 grams per ton (g/t), which is consistent with the records of Gold Mines of Australia, a division of Western Mining Corporation (WMC), under whose management ***the mine produced between 25-30,000 tpa yielding 26-28 g/t—and did so for 25 years.***
7. ***MCO's current JORC resource is 910,000 oz., and we are convinced this figure will be increased substantially as new reefs continue to be discovered,*** for it is clear from both recent drilling programs and the more than 40,000 pages of mining records left by WMC that when they stopped operations in 1959 it was for reasons other than for lack of gold; they in fact left a number of identified gold deposits undeveloped for reasons discussed in the next section of this report.
8. We are particularly excited about the potential of the 220 square kilometers of historic mining tenements MCO has purchased in the immediate area surrounding the Morning Star Mine, ***for without exception none of the mines were worked either below the soft rock of the weathered zone or below the water table*** (the significance of which is also discussed in the next section).
9. These 220 square kilometers of tenements host historic diggings with dozens of mines and literally miles of serviceable adits, shafts, rises and winzes that will significantly reduce exploration and development costs; ***the first 5 of these projects are being explored over the next 18 months in a A\$4.5 million joint venture partnership with the Shandong Tianye Group Ltd,*** one of China's largest and most successful listed real estate and mining companies—one with deep pockets (\$2 billion market cap) and a history of backing successful ventures. The Shandong Tianye Group Ltd. also purchased a 10% equity stake in MCO in order to secure the opportunity to 'farm-in' to the development of these regional tenements.
10. The release of this report has been delayed for a number of weeks while we have assessed the *Resource Super Profits Tax, the specter of resource nationalization as proposed by the current administration, who are now referred to as Robin Rudd and his Merry Band of Chavistas.* We discuss this matter as it pertains to MCO in more detail in the Risks section of this report, but we are convinced the experienced, professional management, which holds 18% of the company, can deliver on their promise to transform MCO into a long life, high grade, low cost gold producer that will deliver substantial dividends in the years to come.
11. ***What we find particularly compelling about Morning Star Gold is the combination of it being a cashed-up company with no debt which is in production and has a number of very prospective self-funded exploration projects underway in an uncertain business climate in which the Australian dollar is weakening, the price of gold is strengthening, and the government is putting up more barriers to entry: we believe this is a recipe for tremendous profit acceleration.***

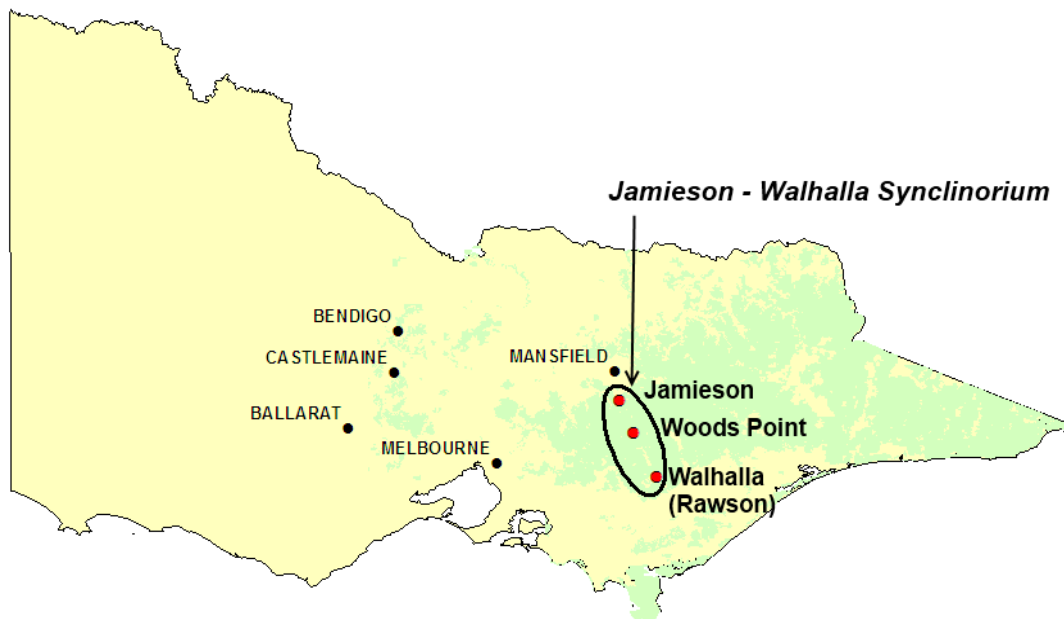
Geology and History of the Area:

- For those conversant in these matters, the goldfields within the Castlemaine-Bendigo-Ballarat 'Golden Triangle,' notably Bendigo, are situated within a deformed, discontinuous sedimentary rock system, whereas the gold found in the Jamieson-Walhalla Synclinorium is contained within diorite dyke upthrusts into the surrounding sediments,

the intrusions hosting quartz reefs and veins; the latter is a very different, far richer system altogether (*for the uninitiated, a rudimentary explanation follows*).

- The Jamieson-Walhalla Synclinorium was the second most productive gold field in Victorian history, producing 110 tons of primary gold and more than 12 tons of alluvial gold, or nearly 4.3 million ounces of gold in all; however, there is no doubt this figure is significantly less than what was actually produced: records were inconsistent between 1861 and 1890 and production figures conflicted as miners had every reason to understate production for government and royalty purposes but to overstate figures for shareholders.
- The Morning Star Gold mine, as well as the company's 220 square kilometers of mining and exploration tenements, is the heart of a relatively rare geologic formation called the Woods Point Dyke Swarm that is situated within the larger Jamieson-Walhalla Synclinorium, a region varying between roughly 10 and 15 km wide by 110 km long that runs through the rugged Victorian Alps in eastern Victoria; these mountains form the southern extreme of the Great Dividing Range that runs nearly the whole length of the east coast of Australia:

Map of Victoria and the Jamieson-Walhalla Synclinorium



Source: Department of Primary Industries

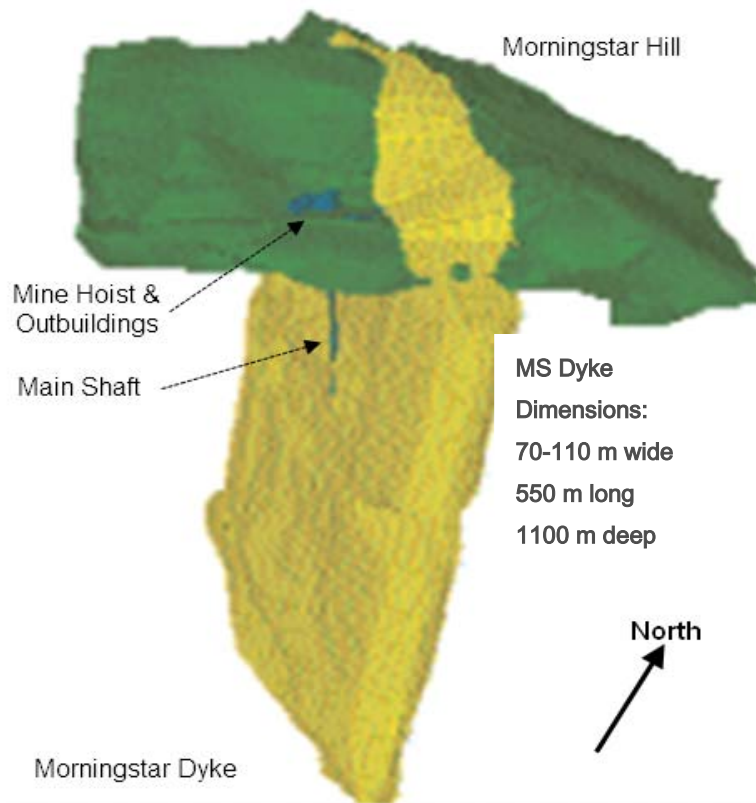
Map by Curnow/MCO & Karn/ETR

- Grossly simplified for explanation purposes, horizontal layers of sediment were deposited on the floors of Ordovician and Silurian seas 350 to 500 million years ago; over time these sediments hardened into slates and sandstones known today as 'country rock.'
- Pulses of magma were thrust up like rising molten wedges that flowed into and expanded the fissures and faults in the country rock; these iron manganese intrusions solidified into

very hard, mainly vertical, wall-like structures called mafic dykes, which largely define the geology of the region.

- Both the country rock and the mafic dykes continued to be subjected to geologic activity producing stress fractures, folds, shears and dislocations along fault planes in both formations that when combined with erosion wrinkle the landscape as the hills and valleys, or ‘synclines,’ we see today.
- At the surface, and as can be seen on the following graphic of the Morning Star formation, the molten rock cooled and solidified into a dyke (yellow) within the surrounding country rock of the hill (green).

3-D Rendition of Morningstar Dyke in Relation to the Topography of Morningstar Hill



Source: Discovery Magazine/ MCO

Graphic Additions by Curnow/MCO & Karn & FRPitt/ETR

- Subsequently, molten quartz upwelled in a similar fashion to and along the path broken by the mafic material, and flowed through the cracks and fissures in the dyke, eventually cooling and solidifying into quartz reefs within the dyke.
- The relentless geologic rending process continued for millions of years, cracking, shifting and sometimes shattering the country rock, mafic dykes, and quartz reefs alike, but finally for the purposes of our ‘*Geology For Dummies*’ description of the Jamison-Walhalla

Synclinorium an upwelling of a different kind of molten fluid followed the path of the quartz reefs through the mafic dykes: gold-bearing sulfides.

- As these molten gold-bearing sulfides oozed up through the cracks between the quartz reef and the mafic dyke, something curious occurred: ***the sulfides in the fluid demonstrated a stronger affinity for the iron in the mafic dyke rocks than for the gold it was bearing, and in the process of the sulfides chemically bonding with the iron the gold literally dropped out of solution, collecting in thin layers of ore called laminations amongst and between the quartz reef and the mafic dyke.***
- This occurred throughout the Jamieson-Walhalla Synclinorium, with the cavities, fissures, and bulges in, as well as the intersections of, quartz reefs in the mafic dyke becoming collection points for rich laminate deposits of gold.
- As can be seen below, freshly exposed, the mafic rock of the dyke is gray mottled with black (manganese), the cream-colored wedge-shaped intrusion is the quartz reef, and the gold-bearing laminations bordering and streaked through the brecciated quartz are a dull, graphite-gray; ranging from 10 cm and 2 m wide, the richest veins are often some of the narrowest.

Plate 1: Maxwells Drive, sub-level 9, Morning Star Mine

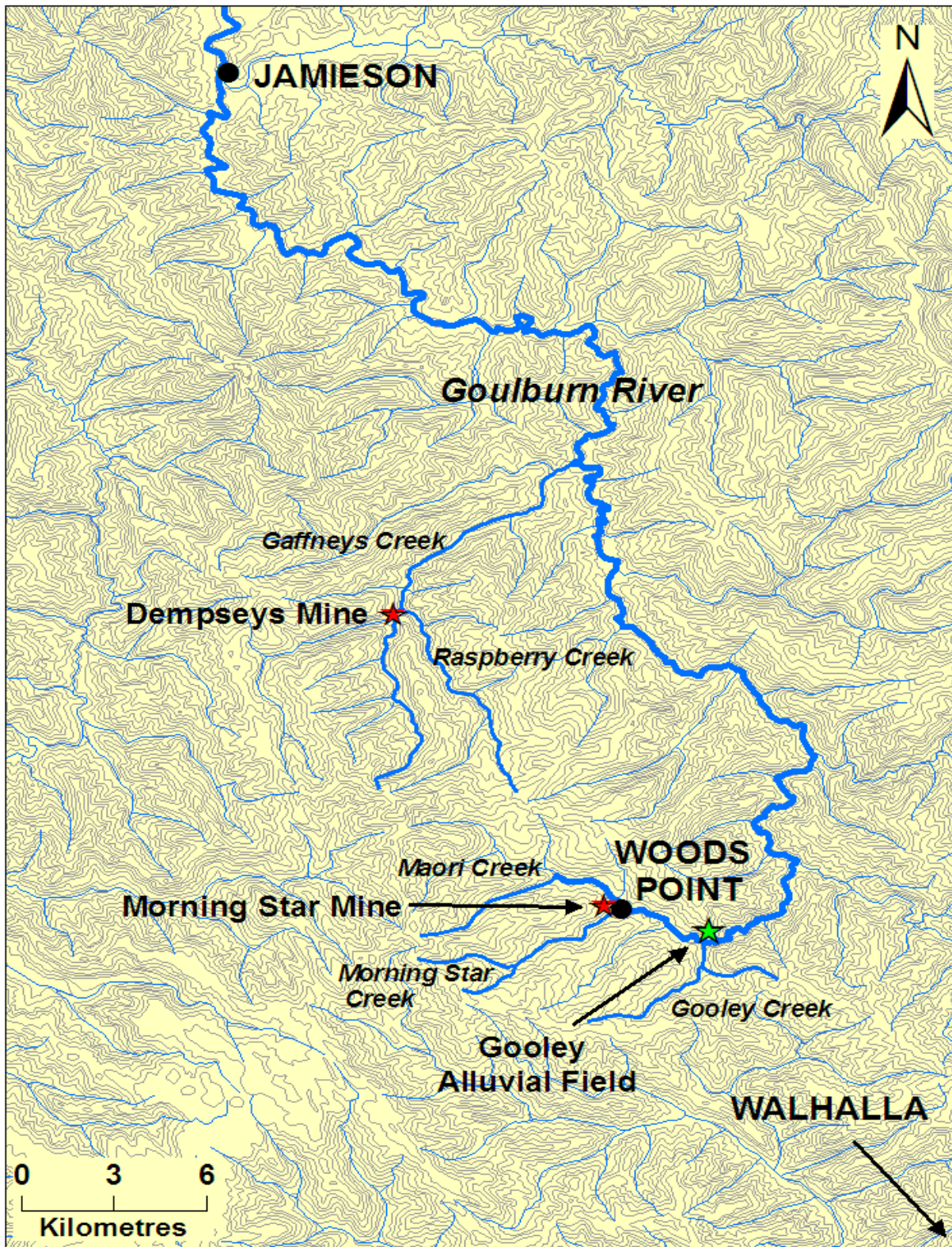


Photo: R. Karn/ETR

- A distinct characteristic of the Woods Point Dyke Swarm is that whereas most reefs and attendant gold-bearing laminations in the Jamieson-Walhalla Synclinorium run vertically as would be expected from this upward thrust of molten material, tectonic activity has resulted in the dykes of the Morning Star Mine having quartz reefs and gold laminations that run horizontally across the dyke at angles varying from steeply dipping to quite flat to sloping from the horizontal.

- The softer country rock surrounding the mafic dykes was gradually eroded, exposing the dykes and quartz reefs; as weatherization weakened the exposed rock (and all exposed rock weakens over time, just at decidedly different rates), bits of gold from the quartz reefs were washed downhill and then downstream, where it tended to collect below the elbows in streams for some lucky alluvial miner to eventually find.
- Unrelated geologically to the Jamieson-Walhalla Synclinorium but integral to its discovery and exploitation was the discovery of gold in the Castlemaine-Bendigo-Ballarat triangle in 1851 which drew miners, all manner of adventurers, and a wide variety of educated professionals from around the world to pastoral Victoria, and by 1853 the population had nearly tripled from 77,000 to 222,000; by the end of the decade it surpassed 500,000.
- This was the new California gold rush—*but even richer*—and led to the establishment of these prodigious (gold mining) rural centers and largely built Australia’s second biggest city, Melbourne.
- Most comers were young men in their twenties from the British Isles that had paid their way as unassisted immigrants, though there were large contingents from continental Europe and America as well that not only had experience mining English coal but California gold and Chilean copper; however, by the time they reached Victoria most found that the best claims in the ‘Golden Triangle’ had long been staked, *so operating on the premise that the best place to find gold was near where other gold had been found they fanned out into the surrounding area.*
- Initially, however, this strategy was not successful because the Jamieson-Walhalla Synclinorium is surrounded by farm and graze land bearing few traces of gold, and it was not until late 1853 that traces of gold were found in the Goulburn River near Mansfield (please refer to the map on page 3); this was followed by the slow push upriver as prospectors found alluvial gold first at Cashines Point near Jamieson in 1854, Enochs Point in 1857, Gaffneys Creek in 1859, and finally Woods Point in 1861, which officially unleashed the gold rush due to a reported 5 ounces to the ton being mined at Morning Star Hill.
- It is difficult to imagine today, but the Victorian Alps are such rugged mountains and so thickly forested with sassafras, blanket wood, blackwood, lightwood and hazel, so densely overgrown with ferns and musk and myriad shrubs *that it took 7 years to prospect the tributaries of the Goulburn River upstream from Jamieson to the Mother Lode in Woods Point, a distance of roughly 35 km as the crow flies but 60 km by road today* (21 and 36 miles respectively).

The Topography and Hydrology of the Upper Goulburn River Area



Source: GA/DPI

Map by Curnow/MCO & Karn/ETR

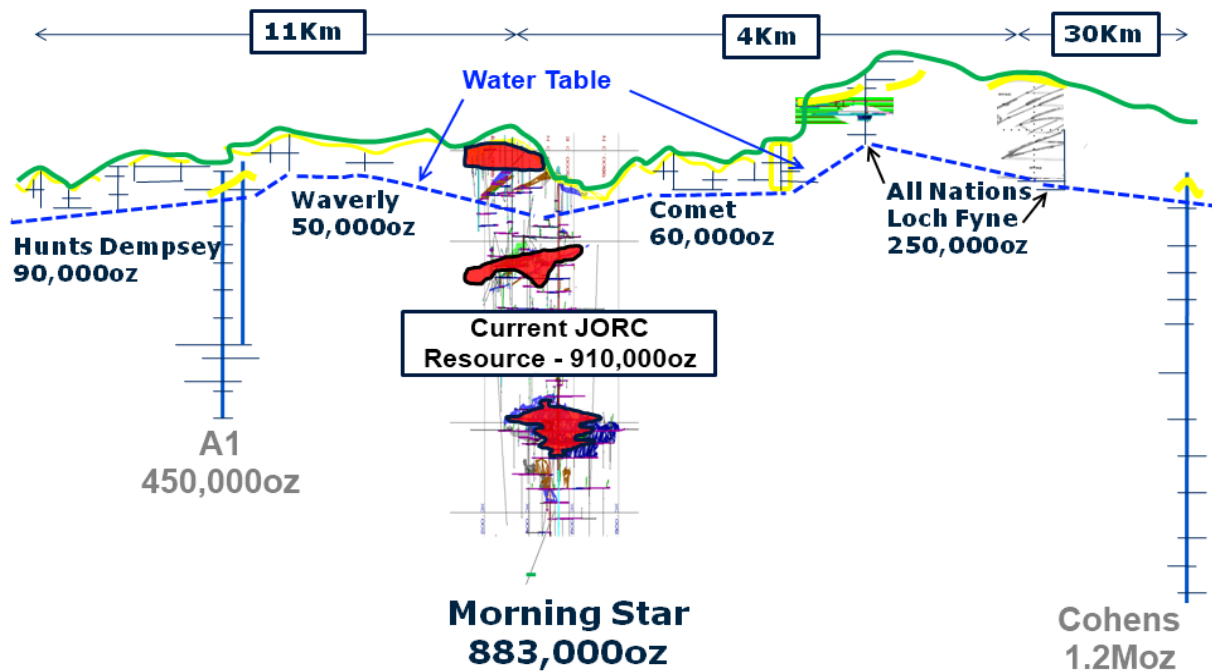
- Tributaries of the Goulburn River, notably Gaffneys Creek, Raspberry Creek, Gooley Creek, and headwaters Maori and Morning Star Creeks, drain the remote north side of the Victorian Alps, and alluvial miners leap-frogged each other upstream panning for gold and searching for its source, the Mother Lode.
- Unlike the ‘Golden Triangle’ where provisions and supplies were readily available via essentially flat road from Melbourne, gold miners on the Jamieson-Walhalla Synclinorium had no road access and hence no cartage for supplies, tools and mining equipment: *they had to ‘bush-bash’ their way in, carrying everything themselves or on pack horses, which both slowed development and increased the degree of difficulty and expense of mining the gold.*
- John Dempsey and John Nolan found rich alluvial gold near where Raspberry Creek joined Gaffneys Creek, but couldn’t be bothered to register their claim until October 1859 as they were more concerned with profits than recognition or government forms; more importantly, they discovered and mined the first quartz reef in the region, which cut across Gaffneys Creek about 300 m upstream of Raspberry Creek and named it Dempseys Reef.
- By burning the quartz and hand dollying, Nolan and Dempsey were able to recover 12 oz of gold a day until they had enough money to go to Melbourne to buy the machinery they needed to upgrade their operations for reef mining; *however, the Victorian Alps were so impenetrable that the crusher had to be built in pieces not exceeding 220 pounds each, which was the maximum load for a pack horse, and the logistics involved in getting the first crusher into the gold field is worthy of a story of its own.*
- By July of 1861, Nolan and Dempsey had built 500 yards of water race and an 18-foot diameter waterwheel of locally sawn timber to drive the crusher: their first crushing produced 1500 oz of gold from 100 tons of quartz, but over the next couple of years the reef beside Gaffneys Creek became increasingly difficult to mine due to the flooding attendant to working below the water table—*‘The water defeated them’* was to become an all too familiar refrain throughout the Jamieson Walhalla Synclinorium (please refer to map of historic production in relation to the water table on page 11).
- In January 1861, Colin and Duncan MacDougall led a well-capitalized, –provisioned, and –equipped party in search of alluvial gold first into Jamieson and then up to Gaffneys Creek, where they profitably sluiced their claim. Gaffneys Creek township was established at this point but was called ‘Lauraville’ after the wife of one of the earliest prospectors. The hamlet’s name was changed to Gaffneys Creek officially in 1900 but the name Lauraville ironically survives today on one of Morning Star Gold’s key regional targets on its Mining License 5299. The Lauraville Mine at Gaffneys Creek forms part of the Hunts Mine, which is due shortly to be drilled and bulk sampled by MCO.
- In February 1861, John and Bill Jones and W.J. Strickland worked their way farther up Raspberry Creek beyond the Dempsey Mine, where they found a rich alluvial claim that was also the abrupt end of the trail of alluvial gold.

- In practice, alluvial gold miners worked their way upstream, leap-frogging other miners' claims in a trial and error application of what is known today as Stream Sediment Sampling: they essentially followed trace amounts of gold upstream until the gold ran out, and then they would backtrack to the last known occurrence and fan out up into the steep, densely vegetated hillsides in search of surface expression, or outcroppings, of the quartz reefs that bore the gold.
- Thinking they had determined the southern extreme of the goldfield, the Jones-Strickland operation saw no reason to climb farther into the range and began searching for the Mother Lode; they were only partly correct when they subsequently found the Castle Reef, which the A1 Mine was to profitably exploit.
- Also in February of 1861, William Gooley set out upriver from where Gaffneys Creek joins the Goulburn with three hired hands and five pack horses, panning the creeks along the way, but that section of the river laid outside the gold belt and after three fruitless months in the bush his employees quit and turned back, leaving Gooley to push on alone.
- In May 1861, Gooley found alluvial gold in the creek that bears his name and pegged out three claims before returning to Jamieson to register them, and a new tide of prospectors swept up the Goulburn; while he was gone, his claim was 'jumped' and in the melee involved in getting it back, Gooley lost an eye, ending his prospecting days.
- Although Gooley was credited with the discovery of gold, and ultimately rewarded £100 for it, it is likely that Big Bill the Native and Bob Wilson, legally challenged property adjusters themselves, had found alluvial gold at what would become known as Woods Point in 1860, but on a re-supply run to Jamieson Big Bill was recognized and arrested and Bob Wilson disappeared without filing a claim, so the honor fell to Gooley.
- When Colin MacDougall heard of Gaffney's discovery on the upper Goulburn, he sent Joe Corry and Dittmer Behrens to investigate, and they found gold and pegged claims at the mouth of Morning Star Creek; after 3 days of working their claims, the two men separated to explore the headwater branches of the Goulburn River and while taking a short cut over the spur between creeks on his way back, Corry dropped into a secluded gully that was strewn with quartz studded with visible gold.
- In mid-July of 1861, MacDougall moved his operation up from Gaffneys Creek and began to develop what became the Morning Star Mine; shortly thereafter with the crudest of makeshift crushers they extracted 33 oz of gold from less than a ton of ore.
- At roughly the same time the Morning Star Mine, which incidentally appears to have been named after the clipper ship that brought the MacDougalls to Australia, was being put into operation, work also began on the All Nations and Loch Fyne reefs below nearby Matlock. (please refer to the MCO tenements map on page 20).
- By September 1861, there were an estimated 1500 diggers working the Woods Point area, but even though the quartz reefs were extraordinarily rich near the surface, and would eventually

turn Woods Point into a major quartz reefing center, *the cost of tools and provisions as well opening a claim were prohibitively expensive*; just how expensive was manifested in curious ways: for example, flat land was at such a premium that in some cemeteries during the boom years miners were buried vertically like something out of a story by Mark Twain.

- *Once below the weathered zone near the surface, the basalt was so hard that it could no longer be hand-mined via the commonly employed 'hammer-and-tap' method, which meant that unless the mine was near a water supply capable of turning a waterwheel it could neither drive the machinery to develop deeper levels nor keep them from flooding once below the water table.*
- It soon became apparent that only well-capitalized companies employing workers for wages, food and shelter would be able to mechanically mine the reefs below the water table; not surprisingly, and as can be seen on the following graphic, the three mines to do so, the A-1, Cohens and Morning Star, were the most successful on the Jamieson-Walhalla Synclinorium; *this suggests there is still a considerable amount of gold to be found at historic workings below both the weatherized zone and the water table.*

Historic Production Relative to the Water Table



Source: DPI/MCO

Graphic by G. Curnow/MCO

- Most of the men employed in the Woods Point fields did not understand quartz mining, so when the Jordan alluvial field opened farther to the south in November 1861, the tide of prospectors chasing gold rushed on; by February 1862 there were 4000 miners working the Jordan gold fields, and Woods Point was considered a backwater.
- The MacDougalls and partners, meanwhile, having proven the richness and extent of the quartz reefs of Morning Star hill, set about preparing to go into production:

- they employed workers to build a water race more than 500 yards long, prepared the crusher site just below the mouth of their adit, and built a 20-foot waterwheel;
- again built in less than 220-pound components for transporting by horseback, the crusher was assembled and put into operation in August 1862, and *the first crushing producing more than 2000 ounces of gold*;
- the proceeds were then put into developing the mine, a second larger crusher, and a second 25-foot diameter waterwheel erected below the first so both could be fed from the same water race.
- Throughout the Jamieson-Walhalla Synclinorium ***water was always a problem, whether too much as in the case of prohibiting work below the water table or flooding alluvial claims, or too little as was often the case during the summer when crushing came to a standstill for lack of it.***
- It was common practice to develop every second or third level and to produce millable ore by underhand stoping off winzes or rises off sub-levels, but ***that meant extensive manual handling and high mining costs as some ore would need to be shoveled as many as eight times before it reached the surface.***
- The first crushing from the Morning Star mine was in August 1862, and by October 1866, when speculation and outside influences led to the first collapse of reef mining in Woods Point, MacDougall's company had paid out £120,376 in dividends.
- From its discovery in 1861 through its closure in 1963, Morning Star mine produced at least 883,000 ounces of gold at a published recovered grade of 24.5 grams per ton (g/t):
 - for the first two decades of its operation the Morning Star mine produced more than 1 oz per ton (28 g/t) making it the epitome of a 'glory hole'—and that was equipped with but 'a clumsy little machine' that happened to turn out more gold than the large, steam-driven batteries in Ballarat and Sandhurst;
 - bought in in 1916, the Morning Star Gold Mining Company operated the mine from 1919 to 1927, in 1920 finding the prodigious Whitelaws reef (please refer to the mine maps on pages 22-3) and sinking the main shaft to approximately the 1000-foot level before the company failed; by 1925 it was estimated that the Morning Star mine had cumulatively produced more than £1,000,000 of gold;
 - in 1934 Gold Mines of Australia, a division of Western Mining Corporation (WMC), put the mine back into operation; employing a high level of professional mining engineering and geological expertise in determining exploration targets, development and mine operations, the Morning Star mine entered its heyday;
 - as can be seen by the cross-section of the mine workings on page 21, most of the development of the Morning Star mine was conducted by Gold Mines of Australia,

which operated the mine *from 1934 to 1959, producing an average of 25-30,000 tons of ore per annum (tpa) that yielded 26-28 grams per ton (g/t);*

- Under Mines of Australia's management, the Morning Star mine for a time was both the largest producer of gold in Victoria (1935) and the oldest producing gold mine in Australia.
- When Gold Mines of Australia closed Morning Star in 1959, they also closed their other 5 eastern gold mines, *but it was not for lack of gold:*
 - More than 40,000 pages of records show they left more than 600 auriferous intercepts on 8 levels, fully one-third of the Morning Star mine, undeveloped;
 - efforts to reduce operating costs by switching from steam-driven to electrical machinery and equipment, in itself an expensive undertaking, backfired famously when the state government demanded repayment for running power to the mine from Mansfield on an accelerated schedule;
 - the resulting high cost of electricity was but the final catalyst that prompted WMC to make the business decision that its money would find a better return elsewhere—as it happened in the nickel boom in WA, closer to its home base of operations;
 - *in effect, trying to mine a metal with a fixed price in such a remote location in a business climate with fluctuating but higher-trending operational costs eventually overwhelmed WMC;*
 - a syndication subsequently formed to maintain operations also failed, even with a variety of state subsidies, and the Morning Star mine was closed for good in 1963.
- Historic reasons for mine closures in the Woods Point Dyke Swarm, then, may be summarized as follows:
 - remote mines in rugged terrain rendered the logistics, as well as the expense, of bringing in equipment, machinery, and provisions a nightmare;
 - while on the one hand flooding was a problem, on the other a lack of easy access to running water for driving machinery and feeding steam plants restrained efforts too;
 - extensive hand-mining not only increased costs but also was restricted to the weathered zone of dykes to a depth not exceeding the water table because few operations had the capital required to power both the drilling equipment to attack the unweathered basalt and the pumping equipment to keep the mine de-watered;
 - the lack of electricity into Woods Point until the 1950's and then at a huge, indeed crippling, cost;

- and fluctuating boom and bust cycles of gold prices, and then a pegged price of gold that increasingly did not reflect the cost of mining it.

Plates 2 & 3: Morning Star Surface Operations circa 1935 and 2010



Photo Courtesy of the Woods Point Museum

Photo: Karn/ETR

Note the stacks of firewood to power the steam boilers in the bottom right of the black and white photo; today, the same space is occupied by roughly 10,000 tons of ore awaiting the installation of the new mill, which will be sited just below where the time stamp appears.

Quick Financial Overview and Management History:

- Cash and liquid assets (31.05.2010): A\$7.5 million in cash
- Debt: NIL
- Number of shares outstanding: 252 million
- Share price (as of 28.05.2010): A\$ 0.38
- Market capitalization: A\$95.8 million
- Most recent quarterly report (31.03.2010):
<http://www.morningstargold.com.au/images/mornstar---zahng.pdf>
- Most recent annual report (2009):
<http://www.morningstargold.com.au/images/mornstar-20--owile.pdf>
- **Management ownership: 18%**
- Top 3 shareholders (Nick Garling, Shandong Tianye Group & Yarandi) vote together & control 40% of the stock
- Top 20 shareholders control 65% of the stock
- **Thumbnail Biographies:**
 - **Nick Garling:** after studying Law at Sydney University, Mr. Garling worked in banking/broking for 21 years, specializing in capital equity raising, asset disposal, structured derivatives and listed markets trading, and became Managing Director of

Equity Markets Group for UBS in Tokyo and Managing Director of Lehman's Asia-Pacific Equity business in Hong Kong.

- **Peter G. Hepburn-Brown:** BSc (Eng), Graduate Diploma in Human Resources, MAusIMM, : holds First Class Mining Certificates in Western Australia, Victoria and Queensland and has over 25 years of diversified mining industry experience from greenfields right through to production; CV includes worked for large-scale gold producers including WMC, Harmony, Niugini Mining, Great Central Mines and St Barbara on successful gold projects such as Bronzewing and Leonora; managed Jundee mine; also sits on the Boards of Alloy Resources Ltd (MCO: AYR) and Medusa Mining Ltd (ASX: MML).
- **Dr. Peter Jackson:** BSc, PhD, MAIG: retired Professor of Geology at La Trobe University; recognized expert in eastern Victorian dykes, including books on the economic geology of MCO's tenement area w/more than 20 years of practical & technical experience in the Woods Point Dyke Swarm.
- **Jeffrey W. Williams:** BSc (Min Engineer), MBA, MAusIMM, AFAIM: mining engineer with 25 years experience in underground mining operations w/CRA (now Rio Tinto) and North Ltd; MD of ASX listed Mineral Deposits Ltd (ASX: MDL).
- **Greg Curnow**(Chief Geologist): BSc (Geology), MAusIMM: 20 years of experience in mine geology globally as well as with narrow vein gold projects in Australia, including WMC operations; previous working relationship w/most of the directors as a senior consultant with the respected Geos Mining - Mineral Consultants, possessing critical experience in water resources and interface with government, advanced skills in micro-computing, and geological modeling (SURPAC) software.
- **Maurice (Mott) Ryan** (Mine Manager): more than 25 years of experience both with large operations like WMC and as an independent contractor to operations such as Hill 50 Gold, Kambalda, Mount Magnet, Leinster and Renison Bell in Tasmania; extensive experience in narrow vein operations and air leg mining; highly regarded jumbo operator and savvy mine supervisor, not to mention being a damn fine cook.

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Current Status:

- late stage permitting, including in situ tailing storage facility plans submission
- new mill scheduled to be delivered in June 2010 and assembled in July 2010
- stockpiling ore from Morning Star mine to feed new mill (+/- 10,000 tons to date)
- recently completed installation of new mine telecommunications system, upgrades to power and pumping capacities, and ventilation upgrade
- first five areas to be mined determined and tonnages estimated
- engineering and site work for new decline to increase haulage underway
- exploratory drilling program attendant to the A\$4.5 million exploration JV with the Shandong Tianye Group has been fully permitted and is advancing on schedule (see map on page 20 and details on pages 27-8).

Discussions with Managing Director, Nick Garling

- Managing Director Nick Garling is quick to point out that “Morning Star Gold is not Lihir Gold,” referring to Lihir’s disastrous foray into the Golden Triangle in an attempt to revive a famous gold mine in Ballarat:
 - The geology of the Castlemaine-Ballarat-Bendigo goldfield is sedimentary host rocks and quartz saddle reefs which is rather ‘nuggety’; on the other hand, the Woods Point area is mafic dyke-hosted quartz reefs that are more homogenous in nature and were the richer of the two fields, averaging just below an ounce of gold per ton of ore;
 - Unlike Lihir’s approach of trying to operate a large tonnage bulk mining operation in a field containing very rich grades found in narrow shoots of gold stringers in quartz rock, Garling believes MCO has the right type of assets to employ a selective approach aimed at minimizing waste rock by using hand-held mining (air leg) techniques in order to become a low tonnage, high grade producer;
 - and, MCO has adopted a patient, flexible approach to putting their primary asset back into production, for they realize full well that if ‘they get it right’ the Morning Star mine’s anticipated 25-year mine life will provide the cash flow to develop its other, more speculative assets that will serve to ‘grow’ the company without dilutive capital raisings.
- MCO’s initial focus will be on getting the historic Morning Star Mine back into production, and they have identified the first five areas they will mine with contract air leg miners (please refer to Site Visit below for details and diagrams).
- MCO’s 220 square kilometers of mining and exploration tenements in the heart of the Woods Point Dyke Swarm offers many years of high value, high odds of success exploration targets in the form of historic workings that are further rendered inexpensive by virtue of the existing adits,

shafts etc; in fact, ***MCO is still finding, cataloguing and mapping exactly what they've got on their tenements.***

- The first five of these historic targets (please refer to the mining tenements map on page 20), the Loch Fyne and All Nations mines (Regional license MIN 5241), and the Rose of Denmark, Dempsey and Hunts mines (Regional license MIN 5299), MCO is exploring with the Shandong Tianye Group in a joint venture:
 - Shandong Tianye Group will invest A\$4.5 million over a two-year period, commencing November 2009, ***in order to ultimately earn a 51% interest in those targets at the completion of the farm-in;***
 - MCO will manage and operate the joint venture during this time;
 - ***The agreement is entirely independent of and excludes MCO's wholly owned and operated mining (MIN 5009) and exploration (EL 5079 and EL 4320) licenses covering the Morning Star, Waverly and Tingha mines as well as the historic Wallaby, Reliance, Comet and Little Comet mines and other regional exploration targets;***
 - Concurrent with the JV announcement, Shandong Tianye Group Ltd also purchased 10% of the outstanding shares of MCO in 2009 via a non-dilutive private placement, wherein MCO's largest shareholders cooperated to enable Shandong to establish an equity position.
- MCO is targeting an initial through-put from their new onsite gravity plant of 30,000 tpa for the remainder of fiscal 2010 grading 12 g/t and 50,000 tpa at 15 g/t for 2011 at an all-in production cost of between A\$600-650 oz (US \$520-560 oz at current exchange rates), which they anticipate generating roughly A\$7 million in profits for fiscal 2010 and A\$14 million for 2011 and ratcheting up from there. (These conservative estimates are based on an Australian dollar gold price of \$1200/oz, which as we go to press is trading at approximately A\$1400/oz, as well as being well below historic production figures from the mine.)
- At that production rate, even without any new discoveries mine life exceeds 25 years, and management intends to develop a dividend program to enhance shareholder returns.
- The results of independent tests confirm historic records detailing that the gold from the Morning Star mine is up to 92% free milling: a 350 micron crush yielded 88% of the free milling gold during the first pass through a gravity plant; MCO intends to crush its ore to 250 microns, or roughly the size of coarse sand, and is confident ~90% of its gold will be recovered as 'free-milling' gold, which will be smelted onsite into 'dore' gold bars, and as a 'middling concentrates' containing roughly 7% of the gold to be on-sold to a refiner.
- Four 15-kg bulk samples were collected from the Dickensons, Burns, and Maxwells reefs and the ore stockpiled by the site of the new gravity plant and sent to Ammtec Laboratories in Perth WA to determine the amount of grinding required to liberate the gold particles for gravity separation, the amount of wear the crushing circuit could be expected to experience in operation as well as to determine the power requirements to do so; the results were:

- the lowest grade material from the Dickensons reef graded but 1.19 g/t and will be used as background ore to fine tune the gravity plant during the commissioning phase; it was not expected that the Dickenson sample would be very rich as the source was waste rock from work done in the 1960's; however, subsequent assays of between 30 and 40 g/t have been recorded from Dickensons reef.
 - the other three bulk samples averaged 55.84 g/t with a combined recovery rate averaging 92.5%;
 - the Bond Abrasion Index, Bond Rod Mill Work Index and the Bond Ball Mill Work Index, which measure how abrasive the quartz is, the power required to crush the ore, and the power needed to grind the ore respectively, came back with elevated values, which was not unexpected given that Morning Star's ore is predominantly quartz;
 - Gekko has designed the Morning Star gravity plant to counteract the abrasive nature of the ore and to save energy by only re-grinding the oversize fraction which does not pass through the screen, which reduces the amount of material that passes through the ball mill to about 10% of the total material crushed;
 - the company plans to market the concentrate containing the roughly 7% of the gold trapped in rocks and sulfides that can only be recovered through a cyanide leach treatment to a third party contractor: 100% recovery can be achieved after 8 hours in leach circuit;
 - ***this means the mill will be significantly smaller, lowering both power and maintenance costs; an additional benefit to this low cost, high efficiency milling approach is that it can be replicated in other locations as the need arises;***
 - ***it is important to note that by not requiring the use of cyanide onsite, it alleviates a range of significant environmental concerns.***
- Once the mill is operational in August 2010 or soon thereafter, MCO will gradually increase mining and milling operations to two shifts per day, doubling the amount of ore delivered to the mill and working toward 'full employment' of 40-45 personnel; after all of the bugs are worked out, a third shift will be added and the mine will operate 24/7.
 - As discussed in more detail in the next section regarding the mine site visit, MCO intends to put the Maxwell and Sub-level 7 (Kenny Reef) areas into production first, likely to be followed by Dickenson's and then Burns; however, the 900- and 700-foot lifts involved in bringing the ore to the surface for milling presents a potential production bottleneck in that each load hoisted to the surface can only carry $\frac{3}{4}$ of a ton of ore, and from the 900-foot level this requires nearly 15 minutes for the roundtrip.
 - MCO is addressing this potential bottleneck by upgrading its winder, head-frame and associated infrastructure to at least double the hoisting rate and capacity of the cage in the shaft, a very significant improvement that has involved rebuilding and recertifying key components of the winder, cage, cables, and braking systems.

- To further alleviate this potential bottleneck as well as to facilitate at least a five-fold increase in haulage, MCO is developing long term plans to drive a haulage decline initially down to level 5 that will employ articulated trucks to bring ore to the surface; as discussed in the Risks section, a decline also offers substantial benefits from a safety point of view in the event of bush fire.
- Cumulative production estimates from the MCO mines exceeded 2 million oz and there can be little question the figure was low-balled; the geology of the dykes as well as local experience dictate the gold-bearing reefs extend far below the weathered zone and water table that halted most mining operations; *MCO plans to venture deeper and is prioritizing targets.*
- *A 2005 geological depth-strike model proposed more than 4 million oz remain below the 200 m level at the Morning Star Mine*, and management is convinced the potential cumulative gold endowment on their tenements will be proven to be in the range of 8-10 million oz and that MCO will grow in to a multi-billion dollar company.
- As it stands, MCO's share price has been fluctuating around the A\$0.40 mark, giving it a market cap of roughly A\$100 million—the market cap at which it begins attracting the attention of institutional money.
- Discussions with Nick Garling confirm that MCO is currently cashed up, with its key capital equipment fully paid for. He's cognizant of balancing the needs between self-funded growth with a future lack of dilution in MCO's share capital but is a realist and understands the company's future needs may involve preferably a non-dilutive capital raising.
- *He stressed Morning Star is currently in the enviable position of being an imminent Australian gold producer that is cashed up and carrying no debt at a time the Australian dollar is falling and the price of gold is rising, thereby increasing profit margins.*

Morning Star Gold Mine Site Visit:

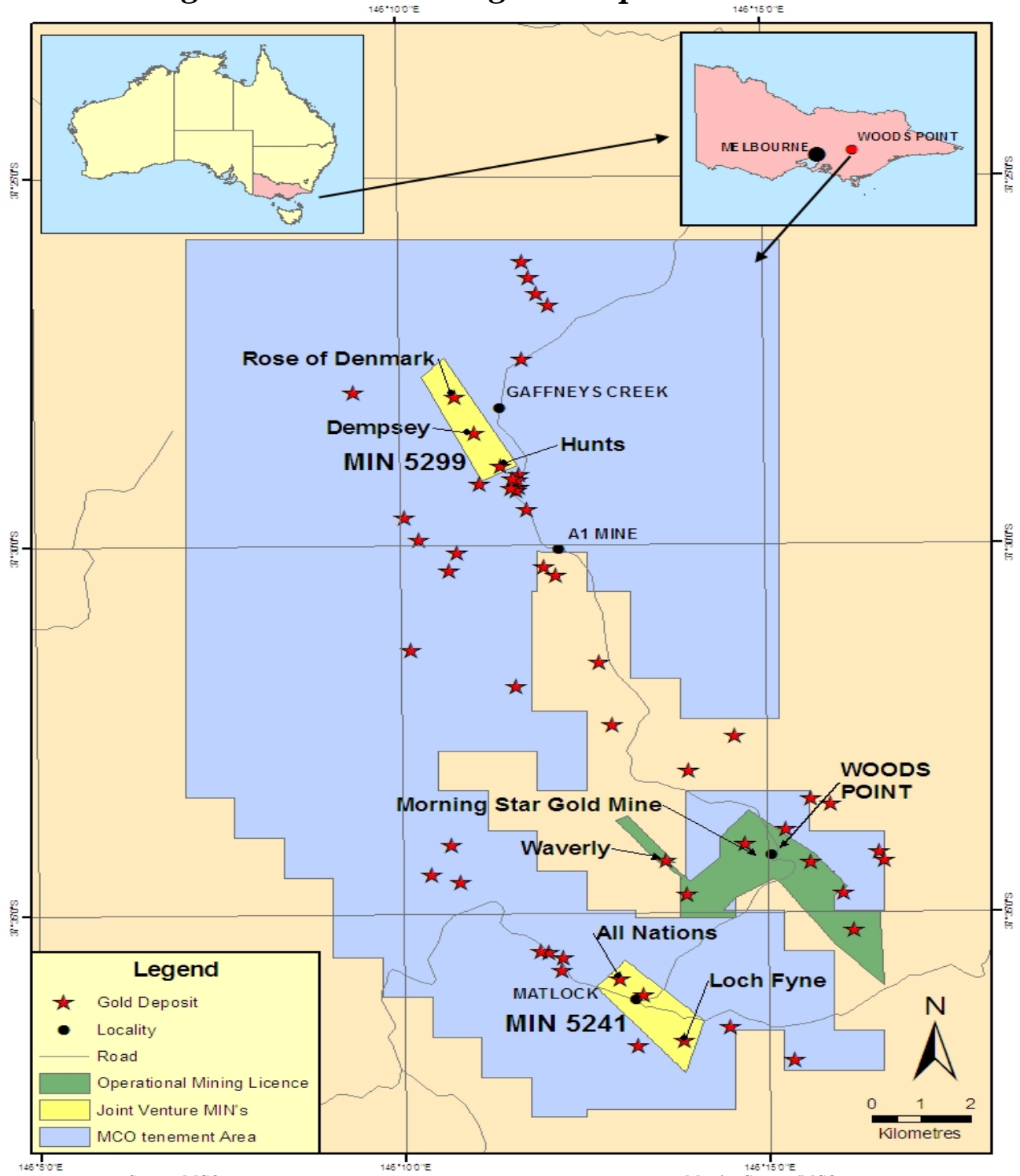
- Driving from Melbourne to Woods Point from the southwest, the tarmac ends just north of Marysville, site of the devastating 2009 bush fire that took 173 lives. The narrow washboard gravel road largely follows the tracks cut by the packers and carting outfits that long supplied the goldfields, and as you wend your way through the densely forested mountains, skirting steep ravines and grinding down in to and then up out of a seemingly endless series of damp valleys, the drive manages to convey a sense of just how impenetrable the Victorian Alps were—and the logistical nightmare involved in getting machinery, supplies and provisions into the area. *Although Woods Point is only about 185 km (110 miles) from Melbourne, the second largest city in Australia, even today the drive takes roughly 3 ½ hours.*
- The little town of Woods Point is strung out along the narrow valleys carved by the headwaters of the Goulburn River, and like remote mining towns everywhere, the quaint sight of canted derelict buildings and abandoned rusty machinery belies the hardship undergone to develop even that. Most of the houses are timber-sided and corrugated-iron roofed, and have seen better days—and have sprouted satellite dishes. Derelicts and 'weekenders' abound. The lots are small and either

border the creek or are notched into the steep mountainsides reflecting a time when flat land was at a premium.

- Today, from our vantage of instant communication and supermarket bounty, mountain scurvy sounds merely oxymoronic and the notion of a community dedicated to prizing gold from quartz reefs is difficult to imagine; harder still to imagine is that as recently as 1939 the little town boasted a population of 1100.
- The Commercial Hotel is the focal point of Woods Point and plays the same role such establishments have played for more than a 150 years throughout the Victorian goldfields, providing basic accommodation, hearty meals, and a well-stocked pub that acts as the social, cultural and political center rolled into one.
- Proprietor Don Woods, who has owned the hotel for more than 40 years, was particularly indulgent with my odd working hours, and I found my stay in Woods Point to be fascinating and immensely enjoyable.
- As would be expected in an isolated mining town that has been out of production for nearly half a century, today the resident population is less than 40, and there is a conspicuous lack of young people. Miners, a grizzled lot to begin with, and hoary retirees dominate, like actors adding authenticity to a frontier theme park.
- As would be expected from a community with a century long mining history, the town is very supportive of the prospect of MCO putting local mines back into production, and MCO's community engagement and support for activities that help support tourism, which has kept the town alive for the last 50 years, are much appreciated; attracting young families will add vitality.
- Heading up Morning Star hill to the mine site, past a mossy yawning adit just above creek level, there is an unassuming pile of gray rock across the parking lot from the mine offices (see photos on page 13) that was indistinguishable to the likes of me from the vast accumulation of mullock and debris that had been dumped down the hillside above the old tailing ponds; it turned out to be roughly 10,000 tons of ore from the Maxwell reef waiting for the new mill to be built so it could be alchemized into the better part of A\$ 5 million worth of gold.
- Most of the 5 days I spent at the Morning Star mine I was with Peter Jackson, Director of Geology; Greg Curnow, Chief Geologist; Mott Ryan, mine manager; and Mark Craig, an air leg mining contractor, all of whom showed infinite patience in explaining things to me, so any inaccuracies in this report are attributable to my thick-headedness.
- The 80,000 tpa gravity plant sited at the Morning Star mine will act as a milling hub, the production from the Rose of Denmark, Dempsey and Hunts reefs initially being trucked the 12-14 km (7-8 ½ miles) over the pass. ***If production warranted it, and the historic mines covered by Regional licenses MIN 5299 are certainly rich high grade prospects, the Dempsey mine already has electricity, making it a logical site for a second mill to service the area;*** at A\$3.5 million, a second gravity plant would not be much of a stretch, perhaps requiring only a few months' profits

to pay off. Then, as other historic mines are brought on line, more such mill hubs could be deployed in a similar fashion to grow production.

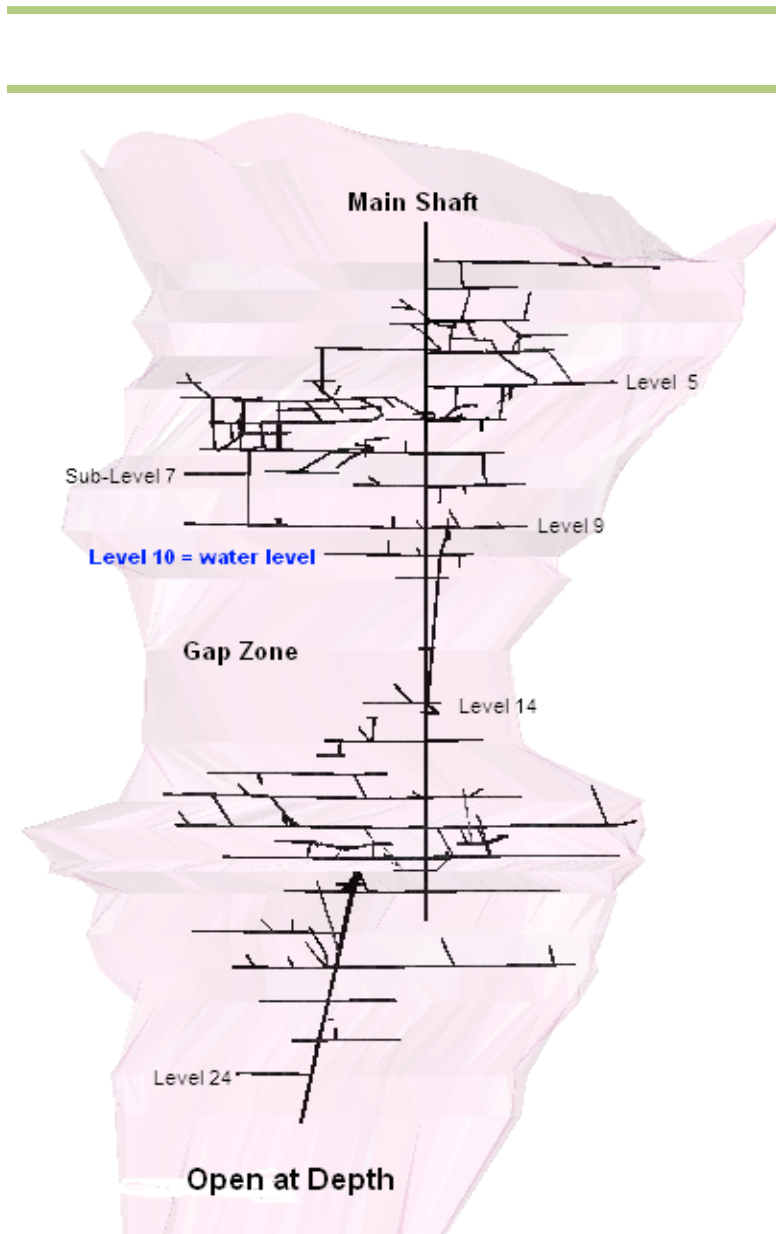
Morning Star Gold's mining and exploration tenements



Source: MCO

Map by Cumow/MCO

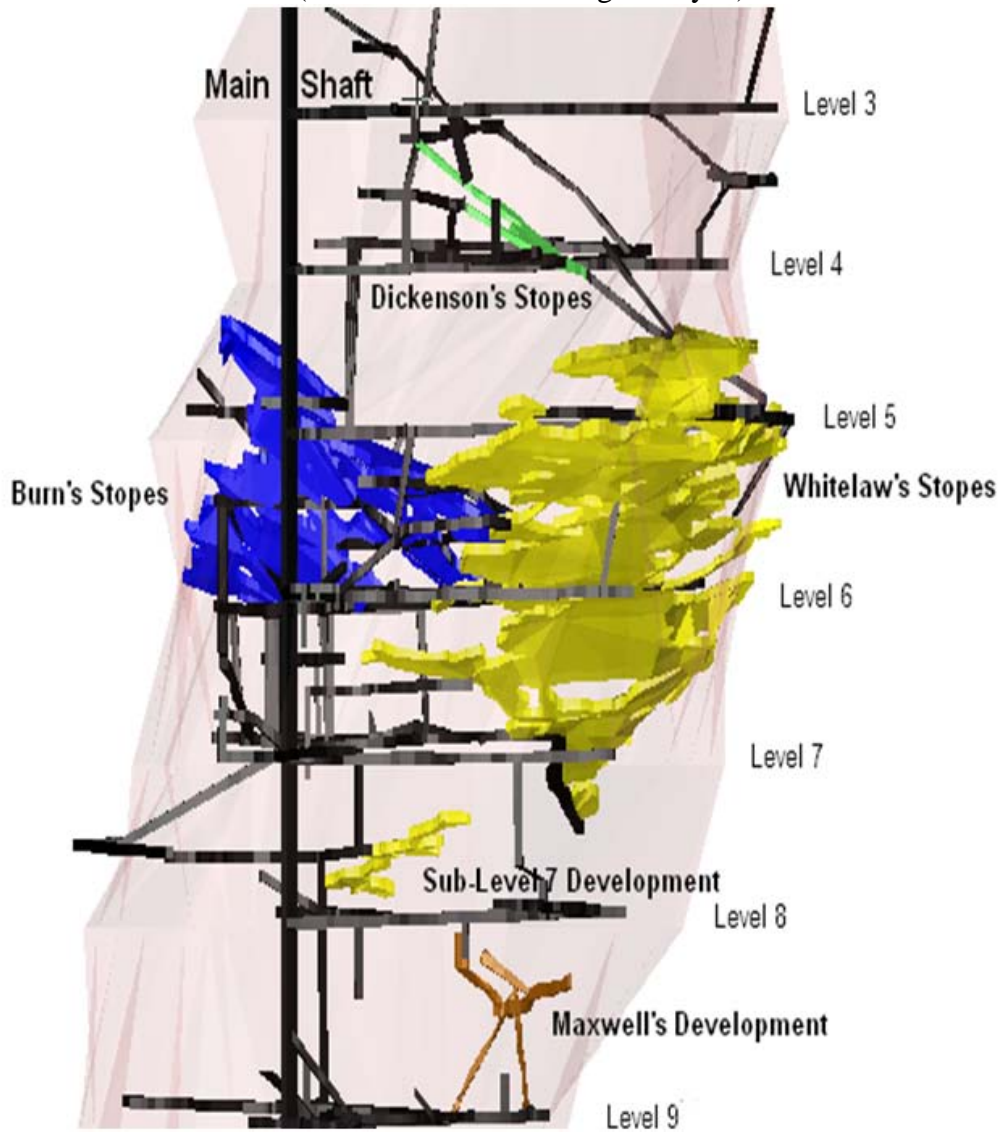
- To the right is a 3-D rendition of the Morning Star dyke (also by Curnow/MCO) similar to that on page 4 **but rotated 40 degrees to the north in order to display its workings.**
- Historically, the zones above level 5 were very rich, often exceeding 40 g/t, and a tremendous amount of 'low grade material' averaging 7-8 g/t was simply left behind because it was below the 11.6 g/t cutoff grade for profitability with the gold processing technology of the day.
- Morning Star mine was worked extensively from the surface to a depth of 50m, from the 120m to 230m, and from 500m to 700m, but there is some controversy regarding the 'Gap Zone' between 200m and 600m, fully 1/3 of the mine's 24 levels, which was neither mined nor explored.
- The mine is open at depth, which simply means it has not been determined where the gold-bearing reefs end.
- It is widely accepted the Gap Zone was never developed due to tragic circumstances: in January 1939 at the height of Morning Star mine's glory days, the Black Friday brush fires devastated most of eastern Victoria, killing 17 local residents, and the town of Woods Point that had housed 1100 at the time was essentially burnt to the ground and has never recovered.



- The outbreak of World War Two then left a shortage of men to work the mine and WMC concentrated on previously identified high-grade targets below level 15; after the war, as costs rose and WMC was high-grading just to stay profitable, there was little opportunity to explore the Gap Zone.

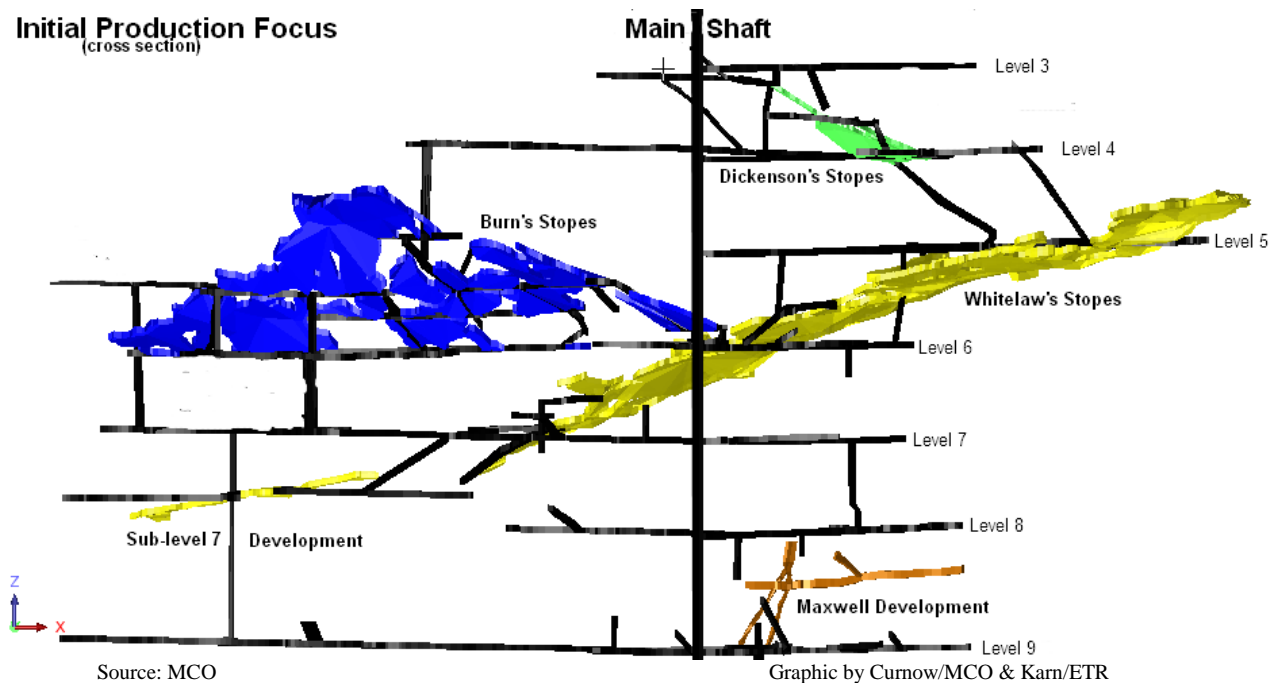
Initial Production Focus

(3-D within the Morningstar Dyke)



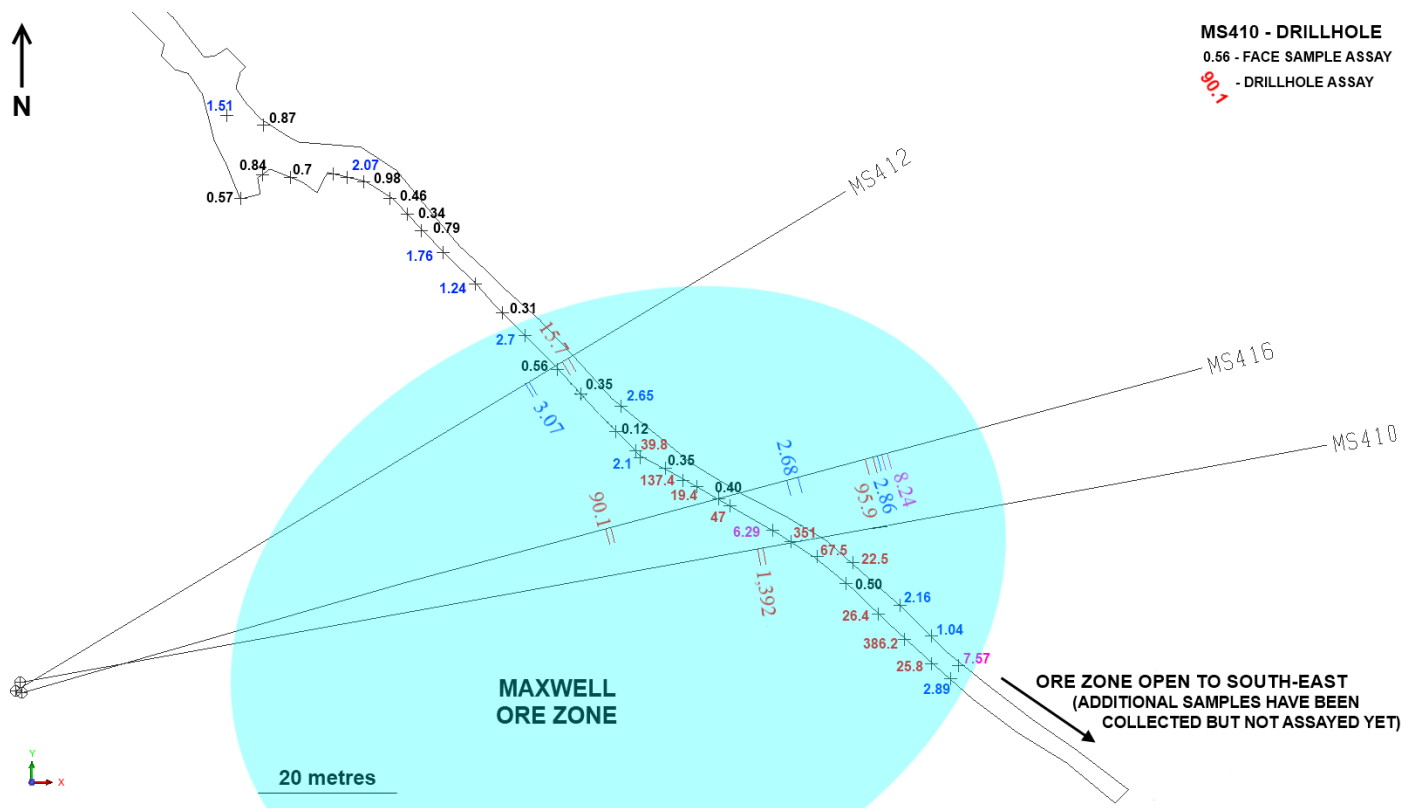
- The colored parts of this 3-D depiction of the upper levels of the Morning Star mine are areas that have already been stoped, or mined, and the colors actually represent the void left by the removal of different ore bodies.

- Initial production targets, in order of priority, are Maxwells, Sub-level 7 (including Kennys which is not depicted), and Dickensons reefs, and Burns reef in the vicinity of where it intersects Whitelaws reef.
- Intriguingly, MCO has submitted a development application to line some of these stoped areas and to pump its mill tailings back underground in what amounts to an elegant, environmentally-friendly waste solution.



- Seen in cross-section in order to visualize the potential scope of the operation, MCO expects to stope approximately 30,000 tons of ore from Maxwells, 45,000 tons from Sub-level 7 and Kennys (not shown), 25,000 tons from Dickensons, and 30,000 tons from Burns, estimated figures being subject to production grade, strike length etc.
- Stopping these four areas of the mine alone will occupy MCO's gravity plant through 2012, by which time development decisions will likely be influenced by exploration results both within the Morning Star mine and in its joint venture projects with the Shandong Tianye Group.
- ***First to be mined will be Maxwells reef***, which varies in thickness along the strike length ranging between 500-600 mm and has numerous zones of visible gold (please refer to the assay diagram on the next page).
- Overall Maxwell development sampling has identified an ore body at least 41 meters long that is open to the southeast; it has averaged nearly 27 g/t from 44 samples, with one hitting 386.20 g/t.

Maxwell Ore Zone & Intercepts (g/t)

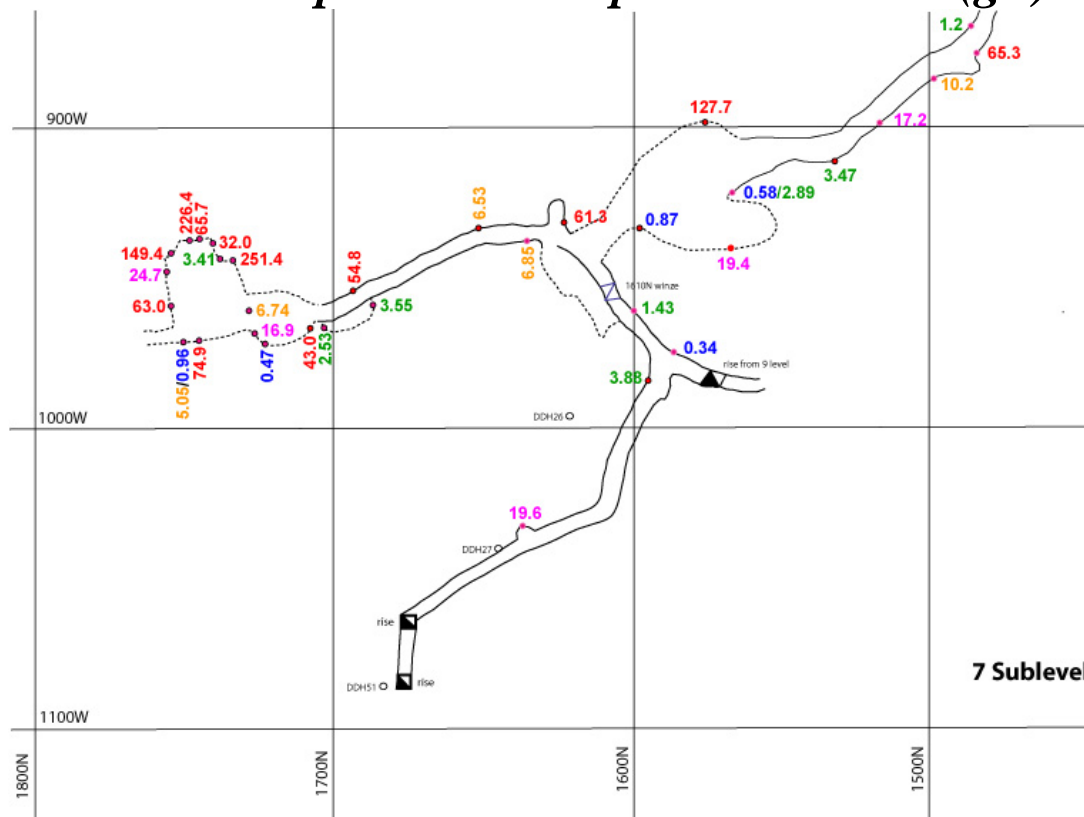


Source: MCO

Graphic by Jackson & Curnow/MCO

- A 14 meter rise has been driven across the Maxwell reef at the edge of the delineated ore zone to facilitate stoping, and a second ore pass has been completed between level 9 and Maxwells to expedite ore transport to the gravity plant on the surface.
- Rail has been laid, water and air put in place—*everything is ready to go into production and awaits only an operational gravity plant to feed.*
- *The second area to be put into production will be the Sub-level 7* that may tie in with, or be a part of, the Kenny reef (not shown on the assay diagram on the next page).
- Access, ventilation and power are being re-established to Sub-level 7 in preparation for the high grade intercepts arcing from the middle left to upper right on the schematic on the next page being put into production.
- This area was one of the last to begin being stoped by WMC in 1959 just prior to the decision to close all six of their gold mines in eastern Australia.

Sub-Level 7 Intercepts in Grams per Metric Ton (g/t)



Source: MCO

Graphic by Jackson/MCO

- Diamond drilling from Level 9 in 2008 suggests Sub-level 7 connects with Kennys reef, which may be indicative of a far larger ore zone than previously thought—*one that management in fact believes is significantly larger and of a higher grade than Maxwells.*
- Intercepts from the 2008 drill program in this area produced high grade assays of 694 g/t and 532 g/t; WMC records show one remarkable intercept assaying over 17,000 g/t.
- Efforts are underway to drive an ore pass down to Level 9 to expedite ore transport to the surface for treatment.
- A second means of accessing the area was started during Q2, 2010.

Miscellaneous Thoughts and Observations from Mine Visit:

- MCO owns 1 surface and 2 underground Kempe diamond drill rigs.
- Mining will be conducted by air-leg contractors, Marlin Mining.
- Although obviously a different generation of miners, I like that a number of senior positions have been filled by people with a history at WMC, who ran the Morning Star mine and were

renowned for the quality and extensive training of their staff; by the way, WMC was purchased by BHP Billiton principally for their Olympic Dam asset in 2005.

Exploration and Development:

- *Historically, the two most successful mines on the Woods Point Dyke Swarm were the Morning Star Mine and the A-1 mine respectively, and their success was directly attributable to venturing below both the weathered zone and the water table* (please refer to page 10).
- Today, Morning Star Gold controls the mining and exploration tenements covering the vast majority of the mines in the area that did not venture below the weathered zone or the water table; *this represents a tremendous prospect as it is well established that gold is there, just that the previous operators were unable for a variety of reasons to access it.*
- MCO has approval from the Victorian Department of Mines for a 35-hole, deep diamond drilling campaign, as well as a bulk sampling program, on the dykes of 7 historic mines within a 10-km radius of Morning Star Mine that produced gold from shallow depths, i.e. the extent of the weathered zone or the water table, whichever they hit first; the serviceable adits and shafts will serve to minimize exploration expense as well as saving millions of dollars in development costs should the mines be put into production.
- The Regional Exploration and drilling program is being developed and managed by Dr. Peter Jackson, Director of Geology.
- *Through May 2010, MCO had conducted 7000 m of underground diamond drill holes over the last 3 years, identifying 5 new reef 'floors' thus far in the Morning Star mine alone. Visible gold intercepts in drilling were also encountered at the Waverly prospect.*
- All indications are that high-grade, gold-bearing reefs are present from the surface to depths beyond 3000 feet in dyke bulges in the Woods Point Dyke Swarm.
- In April 2010, Resource Capital Research submitted that the MCO regional setting held "excellent potential for a 3-4 million ounce resource base."
- Recent exploration has demonstrated that new reefs can be discovered at very low cost, and it seems the more MCO looks, the more they find, but a quick overview of but a few of these prospects includes:
 - *Waverly:* less than 900 m from Morning Star Mine, the dyke is narrow (roughly 8 feet wide), and MCO controls about 5 km of strike length along the most prolific portion of the dyke; *there are indications of 2-3 parallel dykes that have not been drilled;* MCO has completed a 6-hole diamond drill program that delineated the geometry of the dyke and are now in the process of planning an additional drilling campaign from two separate locations; within two weeks of its discovery in December 1863, 15 claims were pegged out over a one-mile stretch of workings despite the dyke being both removed

from and 400 m above the closest water; historic production: 50,000 ounces at 1 oz per ton.

- **Comet:** approximately one mile from the Morning Star Mine, it had historic high-grade production of 64,000 oz;
- **Little Comet:** nearby, this narrow dyke ranges from 6-10 feet wide but over 600 feet long; 3 MCO grab samples in 2008 from the exposed dyke assayed at 8 g/t, 21 g/t and 45 g/t; both Comet mines were historic producers but only worked to a shallow depth; *MCO is currently sponsoring a Monash university student's geological honors project to determine via geochemical testing whether the 'Comet' dykes are related, which would increase the exploration potential of the area and raise the exciting prospect of a virgin dyke between the two.*
- **Reliance:** west of Gaffneys Creek and approximately 10 km from Morning Star mine; prior to MCO undertaking the project in November 2009, there were virtually no historic records or maps of the workings: MCO established that the *historic workings are located in a dyke bulge of significant size, measuring 35m in width, which may put it on a par with the A-1 dyke;* historic workings were very shallow, less than 20 m, and the site is easily accessed; MCO is awaiting approval from DPIV to commence a 3-hole diamond drill program to test the dyke's size.
- **Shamrock:** constitutes essentially virgin territory but was known to host copper, cobalt and palladium in addition to gold; an update will be forthcoming.
- The A\$4.5 million JV with the Shandong Tianye Group will see MCO's new partner ultimately receiving 51% of the proceeds from the gold found in two of the five mineral licenses currently being developed and processed by MCO. These tenements contain mines that generally closed once they reached the bottom of the weathered zone or the water table, whichever came first (please refer to the overall map of MCO mining and exploration tenements on page 20); thumbnail sketches of these mines reveal:
 - **Rose of Denmark:** *significant work has been done to upgrade the access road to an all-weather, all-year standard, and mapping of the underground workings has commenced;* a 120 m blockage is currently being cleared and an underground diamond drilling & sampling program will commence once completed; in 1893 a tribute party mined 2000 ounces at an average grade of 2 oz per ton; historic production: 20,000 oz;
 - **Dempsey:** site of the first reef discovery and operation, a MCO channel sampling of a quartz reef with laminations along a small historic adit ranged from 8-15 g/t; electrical power runs in to site of the gravity plant that was destroyed in the 2006 bush fires; historic production was estimated to be 20,000 oz;
 - **Hunts:** 1 dyke and 1 separate reef; the exposed dyke is highly mineralized and fractured and can be observed underground via the Victoria adit, which at the point where it intersects the Hunts dyke produced grab samples assaying 15 g/t; one drill hole into the

Hunts Dyke in 2006 assayed 135 g/t over 1.4 m and indicated the presence of a number of prospective reefs below the historic workings; the gravel road into the mine has been improved to allow easy access, and the historic adit has been rebuilt and refurbished; production from an open cut operation at the surface of the dyke yielded 20,000 oz;

- **Loch Fyne:** a large dyke measuring roughly 700 by 280 feet; situated at a higher elevation, the historic workings extended down to 750 feet; the original adit is 2000 feet long, of an unusually broad width, and remains in good condition; also mined for platinum group metals (PGM) during World War Two; historic production of 109,000 oz and an unknown amount of PGM;
- **All Nations:** 2 dyke bulges and one reef that was successfully mined for gold outside the dyke; underground access via old mining adits, the underground has been mapped and sampled by MCO, revealing there has been no systematic work conducted on All Nations below a depth of 400 feet from the surface; a 5-hole diamond-drilling program is being implemented as we go to press; historic production was 132,000 oz.
- Ore from Loch Fyne and All Nations would be processed at the Morning Star mill hub, but producing significant amounts of ore from the Rose of Denmark, Dempsey and Hunts would increase the likelihood of the addition of a second mill hub; central to the three mines with electrical power in place, Dempsey appears the most likely site candidate at the moment.
- As an aside, I spent a pleasant evening having dinner and drinks with a delegation of 7 representatives of the Shandong Tianye Group, which included three professors of geology and a Director of open cut gold operation in WA. Over two days we went underground together at three of the JV properties, and during the first two my impression was that they were only mildly curious; however, at the third mine, Hunts, the brecciated quartz reef and laminations sparked a stunning change: from behind the polite reserve emerged excited, animated gold bugs. It was quite an eye-opener.

Risks:

- Price of gold falling enough to make MCO unprofitable: with trillion dollar bailouts becoming the norm (please refer to gold comments below) and central banks worldwide pulling out all of the stops in their interventionist reflation efforts, we find it difficult to imagine that the price of gold will approach MCO's production cost of A\$600-650 oz (US \$520-560 oz at current exchange rates) during our lifetimes.
- What we find more of a threat, and one that struck us like a bolt out of the blue, is the Rudd administration's proposed Resource Super Profits Tax (RSPT):
 - we are in Australia because we believed that in addition to its stunning resource wealth, it respected property rights and contractual law and presented very little nationalization risk;
 - **we were wrong:** the Resource Super Profits Tax amounts to a wealth confiscation scheme designed to transfer the resource wealth of sparsely populated Western Australia and

Queensland to the more populous and apparently more populist states of New South Wales and Victoria;

- that the articles of Federation clearly leave resource royalties in the hands of the states and have no provisions for Federal taxation, meaning the issue may have a constitutional challenge looming, is of little consequence to the populist, “I did nothing to produce, fund or earn the profits from these resource sales, which I already receive 40% for without lifting a finger, but I’m entitled to more of your profits anyway” mentality that has been sweeping OECD economies under the competitive rug for more than a decade has finally reached the shores of the Lucky Country;
- *it is clear from the damage already inflicted to the Australian dollar, the resource sector and the overall stock market as well as to Australia’s well-deserved reputation for stable, sensible government that neither the markets, the industry, nor the Australian people are going to embrace such collectivist malarkey, and it is our sincerest hope they will have to good sense to defeat this measure in parliament as they did with this same administration’s predatory carbon tax/emission trading scheme*, but only time will tell.
- ‘capital goes to where it is treated well’ Dennis Gartman reminds us—and Australia, with its relatively undeveloped capital markets that depend on direct foreign investment to fund resource development, has just witnessed the consequences on its markets, savings and retirement accounts of Mr. Rudd slamming the door on foreign investment just as effectively as has Mr. Chavez;
- ironically, China may in fact be the biggest beneficiary of the RSPT in that being unburdened by the profit motive as such, they may not be as disinclined as western venture capital money to invest in Australian resources under the new tax regime, especially should the Chinese government offer some form of tax credit to offset the higher expense;
- however, being an extraordinarily level-headed people, most of the Australians we have spoken with about the RSPT seem to view it as ridiculous populist politicking, perhaps reflective of the desperate measures an administration that is under siege for an endless litany of miserably failed policies will stoop to in an election year;
- most Australians seem to recognize that that such short term populist greed will cost jobs in the long run, not just in mining but across a broad swath of the economy, adversely affecting everyone from the Mom & Pop shop-owners to the airlines, construction to hospitality workers;
- a number have pointed out that the Chavez-like ploy will backfire because Australians take pride in not being a third world country run by a self-important despot: this is Australia, where everyone gets a fair go—isn’t it?
- we are increasingly optimistic that Australian voters will put the good of their country above the lowest common denominator of self-interest long enough to boot these bums out of office and let what remains of the free markets take care of itself;

- *after studying the situation and trying to gauge the national pulse on the matter, we recommend buying the dips—especially in companies like Morning Star Gold that are fully funded, have remarkable profit potential, and are in production; oddly enough, the the Rudd administration effectively slamming the door on access to equity capital provides competitive advantage to those companies that ‘got through’ before it closed.*
- It has to be accepted that bush fires in the Victorian Alps are inevitable and will be devastating because they are nearly impossible to fight due to the terrain, so putting in a haulage decline will go a long way toward protecting the Morning Star mine as personnel, gear etc can be moved inside on little notice; with gravity-fed sprinkler systems on the roofs of all surface buildings, perhaps the bigger threat is to what infrastructure would be damaged in Woods Point—especially the pub, and what that would do to employee morale.
- Employee turnover: Woods Point is remote, even by Australian standards, and the locals joke about it being “Deliverance” country. Alcohol is a problem in any mining town: hard working folk always seem to bring the same determination and energy to drinking as they do to the rock face. And there is a shortage of young people to bring up through the ranks to man the mines. The family of a young carpenter employed at the mine recently moved to Woods Point, seriously skewing a demographic I would even now place in the mid- to late-40’s range, which is excellent from the perspective of the professional approach that is being brought to bear to mine operations today, but without young miners to bring up through the ranks, it will present a problem a few years down the track.
- No local pool of miners to draw on means MCO will need to attract workers from farther away (see Table 1 below), pay them more to be away from their families and communities, and provide accommodation in Woods Point during their work weeks. There appears to be lots of building that can be renovated, such as the hospital, which MCO has purchased and is renovating for employee housing, as well as the old general store MCO is similarly renovating for mine offices downstairs and executive accommodation upstairs, but by the time MCO is up to full production, something will have to be done.

Table 1: Potential Locations from which to Draw Labor for Morning Star Gold:

City/town (pop)	Distance from Woods Point by Air	Distance from Woods Point by Car	Driving Time
Marysville (300 _{est})	45 km to E	79 km/47 mi.	1 hr. 10 min.
Rawson (280)	44 km to S	75 km/45 mi	1 hr. 30 min.
Jamieson (2700)	35 km to the NE	60 km/36 mi	55 min.
Mansfield (7200)	60 km to NW	92 km/55 mi	1 hr. 30 min.
Melbourne (4 million)	120 km to SW	176 km/106 mi	3 hr. 30 min.

Source: Explore Oz, Google maps

Table by FRPitt/ETR

- There have also been concerns raised about arsenic concentrations becoming elevated over time as the mill tailings are pumped underground into lined stopes and the excess water is recycled through the mill in something of a closed loop; Dr. Peter Jackson’s response to the question was that it is a common, inexpensive practice for the water to be treated periodically with ferro-sulfates to precipitate the arsenic out of the tailings water for proper disposal.

Conclusion:

- The apparent return of the global financial crisis in the guise a sovereign debt crisis compounded by the uncertainty regarding the proposed Resource Super Profits Tax in Australia can only have a negative effect on project financing going forward—*if passed*.
- ***In an environment like this only two things are certain: any project that is not fully funded and in or very near production is suspect, and people will increasingly turn to gold as a means of saving money or protecting their wealth.***
- If credit indeed dries up again, the projects most likely to get developed are either those that can be funded from cash flow or from the company's (or the parent company's) balance sheet, or those that are bankrolled by government-backed entities such as sovereign wealth funds that are less concerned with near term profits than the long term availability of resources to keep their economies supplied.
- ***Morning Star Gold falls into the former category and is backstopped by the latter.***

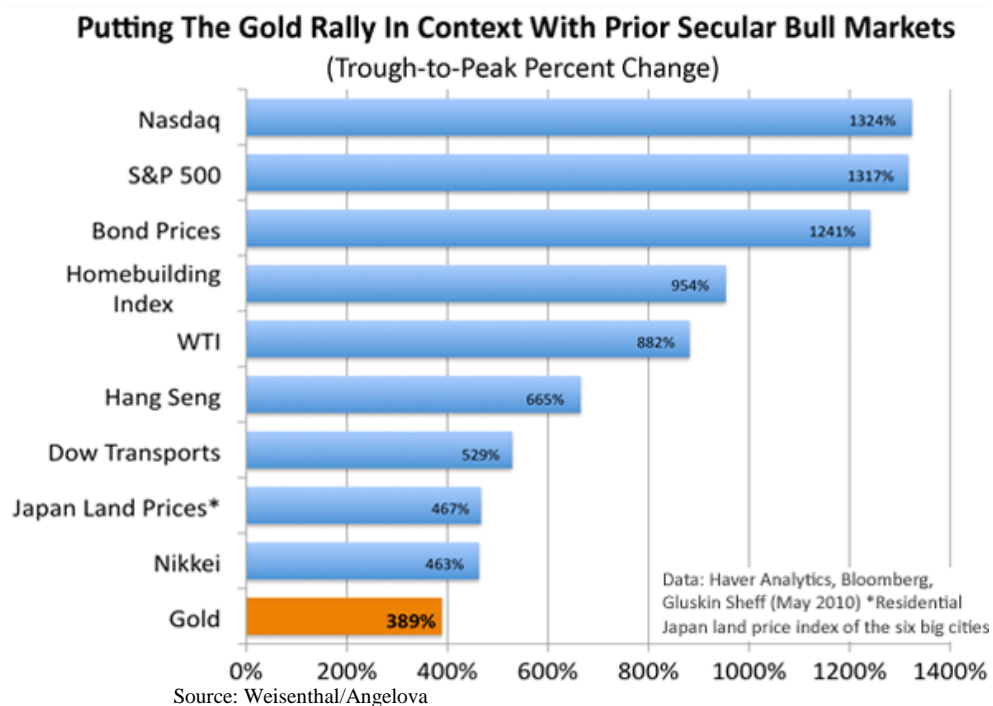
Gold Market Drivers and Thumbnail Sketches:

- Our thoughts and comments on gold are a matter of public record and easily accessed, so we will not rehash them here; instead, we would like to introduce a few ideas for readers to consider during these turbulent times. *However, we urge you to take the precaution of placing sharp instruments out of reach before reading the following.*
- The structural case for gold is compelling and made the more so by the unfolding market realization that the euro is not a foil to US dollar depreciation but is in fact just as unreliable a store of value as measured by purchasing power.
- The evolution from business cycle to bubble cycle to crisis cycle we discussed in ***Credit & Credibility*** continues apace as the frequency between crises shortens and the interventionist response is unfailingly to use the opportunity to its advantage, i.e. spreading populist malarkey, expanding bureaucratic intrusion, and throwing ever larger amounts of money at the very problem their previous policies have created rather than attempting to affect lasting change to improve their citizens' well-being.
- Gold is many things to many people, but at some point in your life, probably when you reach the age that you have worked hard enough and long enough to have something you would like to keep to vouchsafe your family's future, you will probably have to give gold some serious thought.
- To us, gold is the antithesis of a fiat currency and ownership of the physical metal is the best way to 'save money': gold is rare because it is not easily won; its inertness renders it eternal in the sense that it resists corrosion; and although gold is fungible, dilution is easily detected.

- On the other hand, there has never been a successful fiat currency: fiat currency regimes come and go with alarming regularity primarily because of politicians' innate inability to limit its creation; paper money's value is 'always and everywhere' corroded and diluted over time by political ambition conspiring with financial sector greed; it has ever been thus, and is it not different this time: the US dollar is just bigger and more pervasive—and more dangerous.
- With the exception of the French Revolution, hyperinflation, or a currency rapidly and precipitously losing its purchasing power and devastating a people's savings and standard of living, is a 20th century phenomenon: during the 20th century, 20 fiat currency regimes collapsed.
- We have no pretense to understanding the timing of the eventual collapse of the US dollar but recognize its inevitability due to historic precedent and the corruption attendant to its mismanagement; this takes many forms but they are all variants of the inflationary dilution-by-debt mechanism becoming unsustainable, i.e. sovereign debt growth and default, governmental and intergovernmental corruption, cronyism, the expansion of the welfare state, ever more lenient credit terms, the ubiquity of credit cards, margin accounts and NINJA liars' home loans, *which tellingly are now being offered by the government in the form of Federal Housing Authority loans that are being defaulted on at a faster rate than the original sub-prime mortgages*, etc. are but symptoms of the broader corruption of the economic system, but combined they have weakened the system so badly that a seemingly minor catalyst may bring the system down.
- As the global reserve currency, the US dollar, which has been entirely fiat since abandoning all pretense of being backed by gold in 1971, is not immune to the condition the world finds itself in today because it is largely responsible for it: the fiscal profligacy we are witnessing today originated with and was promoted by the financial sector and its cartel mouth-piece, the Federal Reserve Bank, and was aided and abetted by a purposeful lack of agency enforcement that amounted to tacit co-operation.
- During the height of the 2008 global financial crisis, an estimated 30 currencies worldwide were untradeable outside their national borders while inside the costs of anything that was imported, particularly food and energy, exploded; this is in keeping with *the historic trend of the global reserve currency to collapse from the periphery, or frontier, toward the financial center as the rush to the safe haven of the reserve currency has nothing to do with 'return on capital' but 'return of capital.'*
- We find the crisis in Europe today particularly alarming because as far as we can tell Europe is not on the frontier of anything—other than the incremental march of the new socialism being promoted by rabid environmentalism, the authoritarian imposition of political correctness, and the malignant growth of intrusive bureaucracy.
- The fact that the European Union could not find a solution to their sovereign debt problems until the Fed stepped in and quietly re-opened its trillion dollar swap facility is both ominous and anomalous: *it reinforces our contention that all currencies today are but derivatives of*

the US dollar as well as implying that a significant amount of PIIGS debt is going to be transferred to American taxpayers via the Fed.

- Clearly, trillion-dollar bailout packages don't have the 'shock and awe' punch they used too, but then the efficacy of bailouts with worthless paper has been on the decline since end-of-the-world, too-big-to-fail banking crises began in the late '70s: back then it was hundreds of millions, then in the early '80s tens of billions, then in the late '80s and early '90s it was hundreds of billions; today politicians and central bankers bandy trillions about with equal aplomb. If you were wondering what comes after trillions, by the way, it's quadrillions.
- However, the European 'situation' provides us with the second brief, wholly unpleasant glimpse in less than two years into how deformed monetary policy has become: **repayment of loan principal no longer matters; all that matters is that the revenue stream from the interest payments continues to flow to the financial sector so the pretense of solvency can be maintained a while longer.**
- Sovereign debt is a corrupt fabrication: the world's largest economy and issuer of the world's reserve currency is supported by nothing other than the largest sovereign debt in the history of mankind—a debt so large in fact that it can never be repaid, nor was it ever intended to be repaid, **only serviced.**
- Popular recognition of this fraud will be the catalyst that precipitates the inevitable collapse of the global fiat currency regime: we have long maintained that the final bubble under a fiat currency regime will be in gold as people go into a frenzy of panic buying to preserve whatever wealth they have; in the process we expect to see a new, albeit horribly specious 'winner' on the following chart of famous bubbles:



- It is worth noting that Germans are today (end of May 2010) buying gold at the fastest pace since the Lehman Brothers collapse in 2008, which sparked the first trillion dollar bailout; regardless of the action of the US dollar in relation to the euro or other paper currencies, they are all being very rapidly devalued in absolute terms, and while gold is a historic safe haven from central banking and interventionist excess it is wise to contemplate how specious such a rally actually is and what it is really telling us about the purchasing power of our money.
- *It is dawning on taxpayers throughout the US and OECD that the cancer of corrupt bureaucracy attendant to interventionist monetary policy is consuming the socio-economic vigor of their countries; that their voice in government has become as diluted as they have allowed their currencies to become; that they now work to support the lifestyles of civil servants.*
- This is building toward a “I’m-as-mad-as-Hell-and-I’m-not-going-to-take-it-anymore” inflection point, which is why ominous rumors abound about the Obama administration preparing to use special American military troops to confront American protestors this summer and fall in the lead up to the mid-term elections.
- The end will not be pretty: nearly 100 years of increasingly authoritarian rule in the US and the OECD suggests the perpetrators will not just go quietly into the night when their fraud is exposed; the stakes are immeasurable and an attempt to impose draconian legislation both to perpetuate the fraud and to maintain power seems inevitable.
- And, as Lenin, FDR, and Mao and many others demonstrated during the 20th century, the best way to hide the theft of both their citizens’ wealth and their civil liberties is by confiscating gold, thereby removing the only measure by which their economic policies can be measured as well as destroying the last vestiges of a belief in, and respect for, property rights: *plan accordingly*.

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