

400 Years of Silver from Peru

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I've just returned to the aftermath of hurricane Katrina in Miami after two weeks of solid travel and visits to two of the most incredible junior mining stories I have come across. I have recounted my visit to Greenland and Baffin Island in [a piece](#) posted on Sept 6 and now it's time to tell the tale of a 400-year old silver mine which may require investors to accept an entirely new business model.

Seeing opportunity, Simon Ridgway, President of Radius Gold, wanted to get into the silver business. He assigned Jorge Ganoza, a Peruvian mining engineer, the task of finding a suitable silver mining project in Peru, well known for massive silver deposits. Based on my trip to the property, the year-long search for silver has paid off in spades.

Jorge Ganoza found a 400-year-old silver district complete with 21 million ounces of resources, a 700 ton per day mill, 30 distinct silver veins and a whole load of blue sky potential in the Caylloma silver district high in the Andes, 245 KM northeast of Arequipa. Over the past 400 or so years, the district has produced about 250 million ounces of silver. About 100 years ago, a German family named Hochschild began to consolidate the entire district and by 1983 had the district under their sole ownership.

Here's where silver investors need to begin to think differently. Traditionally in Vancouver mining circles, a mining company starts a mine or takes over a mine, does a complete scientific exploration program and mines out the deposit only to move on to the next deposit. But how do you do that with a 400 year-old district which may well have another 400 years of production? The Romans and Spanish never drilled. They found a vein or two and drifted on those veins until they ran out of ore. They were long term oriented and looked at mining assets as having hundreds of years of mining potential. More importantly, they didn't explore. In 400 years, they hadn't needed to explore. There were silver veins all over the place.

5,000 year lows for silver finally bit them on the butt and in 2003 the Hochschild Group stopped mining at Caylloma after producing 2.6 million ounces in 2002. They paused to regroup and for the first time in the history of the district began to do a modern job of exploration. Between 2003 and 2005 they spent about \$2 million dollars to add 7 million ounces of reserves and 14 million ounces of resources.

Ridgway's timing couldn't have been any better and months of discussions between the Hochschild Group and Fortuna resulted in the purchase of the Caylloma district for \$7.55 million dollars US and issuance of shares totaling 10.8% of the fully diluted shares of **Fortuna Silver**, the shell Simon rolled the deal into. At the end of the day it means that Fortuna was buying silver for \$.35 and ounce and got \$10 million dollars worth of mill/equipment and another, perhaps \$15 million dollars worth of infrastructure thrown in for free. The Hochschild Group gets a nice cash infusion and retains a substantial piece of the action via the shares.

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The Caylloma district consists of a valley running roughly north/south at an elevation between about 15,000 and 16,000 feet. The mill and camp are located on the valley floor and all of the mining/exploration to date has taken place on the eastern slopes of the valley. To say the district has been barely scratched is to understate the obvious. All of the exploration has taken back over the past two years and you can trace the vertical silver structures visually on the western slope of the valley. There has been no exploration of the western side of the

valley.

Many years ago, after I got out of the Marine Corps, I worked for Ross Perot at EDS for 18 months. He was a strange duck but he had some good ideas. One of his favorite sayings was that you should burn down your business every year. In other words, you should reinvent your company on a regular basis if you wanted to compete.

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It took \$4 silver for the Hochschild Group to consider reinventing themselves. They did an excellent job of exploration and added ounces for a tiny \$.06 an ounce. But they didn't follow through. The Animas vein, source of 60% of the additional reserves and resources consists of a 1.2 meter high grade silver core with 5-10 opt. The Hochschild Group drifted on the narrow high grade silver band at the center of the Animas vein. But surrounding the high grade core is a lower grade silver (2-7 ounce silver) mixed with both lead and zinc ore. Since zinc in the silver/lead concentrate actually reduces the value of the cons, Hochschild didn't count the silver/lead/zinc as part of the resource since they didn't want to make any more investment in the mill.

By spending about \$700,000 Fortuna can add a zinc flotation circuit and mine all of the up to 20 meter width of the Animas vein. They estimate the ore body as being three to seven meters with values of two to seven ounces of silver, 3% to 8% lead and 7% to 12% zinc. They also intend to increase the capacity of the mill from 700 tons to 1000 tons per day. By increasing the width of the vein mined, it's possible they can move to larger equipment and reduce the cost of mining.

Fortuna has just announced a \$2 million dollar 20,000 meter drilling, exploration program with an interesting twist. They are at the center of the Animas vein drilling outward. So while most companies drill more or less blind in the hope of finding ore, Fortuna is in ore and drilling only until they hit the barren hanging wall or footwall. Their exploration expenses and cost of finding an ounce of silver will be a fraction of what Hochschild spent.

With Jorge Ganoza Jr in firm control of the Peru side of the company, along with his father Jorge Ganoza Sr, another long time mining engineer, Ridgway appointed Peter Thiersch as President of Fortuna Silver Mines. The first task of management was to try to define their business model. Initially they wanted to accelerate getting the mill back into production to get cash flowing. But the financial gnomes of Vancouver told them no one would take a silver company with only 21 million ounces of silver seriously and suggested they add ounces first.

Presently they are saying the mill will be back in production between 12 and 18 months from now. They could accelerate that if they really wanted to. They are working hard at getting the industry to recognize a new business model, that of a profitable silver/lead/zinc mine with a very large resource base potential.

Their model resembles that of Endeavour Silver and First Majestic Silver but my belief is that Fortuna will be much larger than either of those Mexican based companies. They pretty much can add ounces at will. They have set out a goal to double or triple the current resource with the current \$2 million dollar program and it seems achievable. By producing lead and zinc and applying that cash flow against the cost of production of silver, they believe they can produce 6 million ounces in silver equivalents, per year, for between \$3 and \$4 an ounce.

Silver is a strange commodity followed by some of the worst writing and nonsensical logic in the precious metals business. First of all, silver is not a monetary metal, it is a commodity metal. I believe we will one day go back to a gold standard where silver will find a most important role as a monetary metal but for now it's a commodity metal and price is determined by supply and demand, not some mysterious conspiracy. The simple reason the

POS got so low was that it used to be a monetary metal and there were uncounted billions of ounces of silver all over the world hitting the melting pots for the last 40 years. You can argue it should be a monetary metal but until it is, silver will be cheap. Silver is too small a market to be worth manipulating, it would make more sense to pump and dump Microsoft.

One of my favorite urban myths is the "silver is rarer than gold" story. By ignoring the billions of ounces of production of silver between 1500 and 1810 from Peru and Mexico and Bolivia which ended up first in China and then in India, the silver scalliwags use a form of voodoo economics to "prove" there are more ounces of gold above ground than ounces of silver. Right! That's why gold is \$444 and silver is \$7, because the 25,000 or so people who make their living trading gold and silver don't know which one is most valuable.

Silver should be a monetary metal and it may be a monetary metal one day but it is not today. It has thousands of valuable uses as a commodity metal and more are being found every day but don't look for silver to hit \$100 an ounce while everything else stands still. It ain't gonna happen.

That said, there are a number of efficient small silver producers coming on line who expect to add an entirely new concept to silver mining, that of producing silver at a profit. I know it's an unusual concept and will be met with considerable resistance but think of it, mining at a profit. What a unique idea.

Even \$7 silver has been a high enough price to start a lot of operations. I can think of Endeavour Silver, First Majestic and Palmarejo, who all have nice deposits in Mexico. Mag Silver has an important JV with Penoles and it's simply fiction to say or believe no one is ever going to produce silver again. We have gone through a 50 year period where there was a surplus of silver and the price reflected it. Silver miners are starting to respond to an increase in the POS. Supply and demand really does work the way the textbooks suggest they should.

Fortuna is setting itself up to be a leader in the silver business. It will be easy, in silver mining there simply hasn't been much leadership. Management expects to continue an aggressive program of expansion both internally by adding ounces of resources with ounces of production and externally through acquisition.

One aspect which few onlookers will understand immediately but will become more important over time is in the age of the management. Fortuna's President, Peter Thiersch is only 44 and their head in Peru, Jorge Ganoza Jr is only 35. There is a lost generation in mining. No one has been coming into the mining business for the last 20 years for lack of opportunity. And the current generation of mining leadership is in their 60s and beyond. There are but a handful of mining executives in their 30s and 40s and one day soon the industry will be turned over to them because all of us old farts will have kicked the bucket. The young guys are going to get a lot of opportunity if for no other reason than there aren't that many of them around.

Fortuna has been an advertiser for a couple of months. Actually they only did the deal with Hochschild in June and hit the ground running. The stock levitated between \$.70 and \$.80 for a couple of months only to get kicked into gear when Lawrence Roulston released his piece on the company last week. We like the company enough that we participated in the recent \$.75 private placement. This piece is not paid for by Fortuna and they played no part in writing it other than simply double checking my facts.

I really like the concept, I love the project and management. The silver portion of the precious metals business has a big void where leadership should be and in my opinion, Fortuna is in a unique position to fill that void. I'd like to see leadership in silver, it's a commodity worth investing in.

You are responsible for your own business decisions and investments. Everything I write is only my opinion and as a shareholder of Fortuna Silver, I am biased in favor of the company. The trip was exhausting, going over 15,000 feet was enough to give us all altitude sickness but it was equally exciting. You will be hearing a lot more about Fortuna in the future and I expect the shares to reflect their real potential very soon.

Fortuna Silver Mines, Inc

FVI-V \$1.04 Canadian 25.7 million shares outstanding fully diluted.

Fortuna Silver Mines [website](#)

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