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CAPSTONE MINING CORP.

CS-TSX Recommendation **\$1.17 BUY**
 Target Price (from \$1.90) **\$1.75**
 Projected Return **49.6%**

Market Data

52-Week Trading Range	\$4.47 - \$0.65
Shares Outstanding, Basic (mm)	164.7
Shares Outstanding, FD (mm)	165.5
Market Capitalization (mm)	\$192.7
Enterprise Value (mm)	\$209.7

Financial Data

Net Debt (mm)	\$115.0
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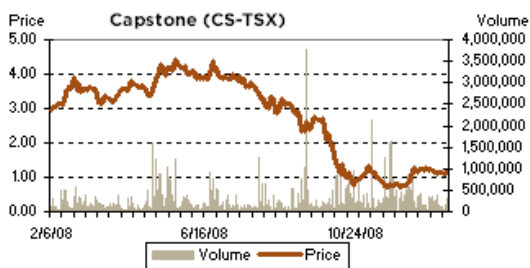
Forecasts

FYE:	2007A	2008E	2009E
Production (mm lb)	8.418	46.807	61.984
Cash Costs/oz	\$1.75	\$1.24	\$1.00
EPS, FD	\$0.01	\$0.58	\$0.29
CFPS, FD	\$0.02	\$0.63	\$0.35
NAV/sh, FD		\$2.18	

Valuation

P/E, FD (x)	n/m	2.0	4.0
P/CF, FD (x)	74.5	1.8	3.3
P/NAV, FD (x)		\$0.5	

Source: Reuters, company reports, Blackmont Capital Inc.



Source: Reuters

Company Profile

Industry: Mining: Base Metals & Minerals
Description: Capstone is a Canadian mining company operating the Minto mine in Canada and the Cozamin mine in Mexico.

Changes at a Glance

2008 EPS	↑	\$0.58	Target Price	↓	\$1.75
2008 CFPS	↑	\$0.63	2009 EPS	↓	\$0.29
2009 CFPS	↓	\$0.35			

See important disclosure statements at the end of this report.

Low-Cost Copper Producer

Executive Summary

Capstone Mining Corp. (CS-TSX) released production results for 2008 and guidance for 2009. In-line with our estimates, Capstone achieved total production of 74.1mmlbs of copper in concentrate from the Cozamin and Minto projects. We estimate 2008 cash costs of roughly \$1.07/lb reflect substantial by-product credits from silver, gold, lead, and zinc.

Management provided production guidance for 2009 of 95-105mmlbs of Cu (approx. 60% from Minto and 40% from Cozamin) at a cash cost of \$1.00/lb for each of the mines.

Both Minto and Cozamin are high-grade low-cost projects located in safe mining jurisdictions. We recommend Capstone as a survivor through the current lower metal prices based on its low-cost operating assets, experienced management, and adequate balance sheet. We expect the base metal market to recover in the latter half of 2009 due to the supply response from producers.

Capstone maintains a hedge book of approximately 104mmlbs Cu worth about C\$120 million. In addition, the company added C\$15 million to copper inventory in Q4, which should be released in Q1/09 due to the Yukon River freeze-up. Debt is estimated at C\$35 million and management recently secured a \$40 million revolving line of credit through the Bank of Nova Scotia.

However, based on the new production guidance we are lowering our target price to \$1.75/sh from \$1.90/sh based on 0.8 times our NAV of \$2.18/sh. The previous NAV was C\$2.37/sh.

Mining: Base Metals & Minerals

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Operations

Capstone has 100% ownership in two operating projects, Cozamin and Minto, and one development project, Kutcho. The Mexican and Canadian mining jurisdictions pose substantially fewer political risks than others.

Figure 1: Map of Operations



Source: Company reports

Cozamin is located approximately 4 km north of Zacatecas City in the state of Zacatecas, Mexico. The infrastructure is in excellent condition with road, power, and water access serving the mine site. Cozamin is an underground mine with a flotation mill to produce copper concentrate. CS has proven and probable reserves at Cozamin of 3.7Mt grading 2.4% Cu as a subset of a measured and indicated resource of 5.5Mt at 2.5% Cu representing an 8-year mine life with potential to grow as reserves are proved with further exploration.

Minto is located in the Yukon, 240km north of Whitehorse, Canada. The mine began operations in October 2007 with a conventional open pit mine and crushing, grinding, and flotation circuit to produce copper concentrates. Concentrates are transported to the coast and exported via the Port of Skagway, Alaska, to smelters in Asia. Use of the roads is subject to the freeze and breakup of the Yukon River in the fall and spring of each year. At Minto, proven and probable reserves total 9.1Mt grading 1.9% Cu from a total measured and indicated resource of 19.3Mt at 0.9%. The reserve currently provides 8 years of mine life but has potential for growth as drilling continues.

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The Minto mine was acquired in late 2008 as a result of the merger between Capstone and Sherwood Copper (SWC-TSX). Capstone issued 1.566 shares for every Sherwood share, representing no premium to the Sherwood share price; however, the C\$240 million deal did give Sherwood some much-needed scale and additional free cash.

Well before the deal with Sherwood Copper, in June of 2006, Capstone spun out all existing silver projects to create Silverstone Resources Corp. (SST-TVX) and subsequently sold all silver and gold production from both Cozamin and Minto to the new entity. The most recent deal was an up-front \$37.5 million cash payment from Silverstone for the precious metal production from the Minto mine plus a further payment of the lesser of US\$300/oz Au and US\$3.90/oz Ag. This allowed the convertible debentures to be redeemed.

Capstone maintains a hedge book of about 104mmlbs Cu worth approximately C\$100 million. The company added \$15 million to copper inventory in Q4 due to the Yukon River freeze-up, debt of roughly C\$35 million and a revolving line of credit through the Bank of Nova Scotia for \$40 million. We believe Capstone will use 2009 positive cash flows to pay down debt and bed the operations down, with a focus on efficiencies.

Production

Capstone released production results for 2008 and guidance for 2009. 2008 was in-line with our estimates at production of 74.1mmlbs of copper in concentrate at a cash cost of \$1.07/lb. The production guidance for 2009 forecasts 95-105mmlbs of Cu (approx. 60% from Minto and 40% from Cozamin) at a cash cost of \$1.00/lb. We were somewhat aggressive in our 105mmlb estimate and have pared that back to 99mmlbs of Cu in 2009. We had predicted cash costs of \$0.81/lb, principally due to both operations running at full production, the weaker C\$, the Hydro hook-up, and exceptionally high grades. Indeed, to meet the \$1/lb mark, we have to assume much higher stripping, which may well be the strategy.

Management

The management team at Capstone has a proven track record. Darren Pylot, Vice-Chairman, CEO and Director of Capstone and CEO of Silverstone brought Cozamin into production. Stephen Quin and Bruce McLeod, both Directors of CS and the former is the new President and COO, were instrumental in the acquisition of the Minto project for Sherwood as well as the more recent business combination with Capstone. Both brought Sherwood from the exploration stage through permitting and construction ahead of schedule and into production.

Sensitivity

The following figures outline cash flow and net asset value metric sensitivities to changes in metal prices. Figure 2 shows how cash flow per share and free cash flow are affected by the denoted copper price with zinc and lead prices set at 50% of the respective copper price. Figure 3 uses the same criteria with metal prices flat through the life of the projects to show Capstone's net asset value sensitivity.

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Figure 2: Cash Flow Sensitivity

	2009			2010		
	Copper Price (US\$), Zn & Pb @ 50% of Cu					
	\$1.00	\$1.50	\$2.00	\$1.00	\$1.50	\$2.00
CFPS	\$0.22	\$0.36	\$0.50	\$0.17	\$0.29	\$0.42
FCF (mm)	\$32	\$56	\$79	\$25	\$45	\$65

Source: Blackmont Capital Inc.

Figure 3: NAV Sensitivity

	Copper Price (US\$), Zn & Pb @ 50% of Cu		
	\$1.00	\$1.50	\$2.00
NAVPS	\$0.11	\$1.48	\$2.86

Source: Blackmont Capital Inc.

Valuation

Based on the fact that Capstone operates high grade copper mines in safe jurisdictions, is led by a proven management team, and is cash flow positive in a stressed pricing environment, we maintain our Buy recommendation and \$1.75/sh 12-month target price based on 0.8 times our NAV of \$2.18/sh. The previous NAV was C\$2.37/sh.

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Appendix 1: Financial Summary

	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Copper Price (US\$/lb)	\$3.14	\$1.50	\$1.70	\$1.80	\$1.80	\$1.80	\$1.80
Gold Price (US\$/oz)	\$300.00	\$300.00	\$300.00	\$300.00	\$300.00	\$300.00	\$300.00
Silver Price (US\$/oz)	\$3.90	\$3.90	\$3.90	\$3.90	\$3.90	\$3.90	\$3.90
Exchange Rate (Cdn/US)	\$1.04	\$1.18	\$1.11	\$1.11	\$1.11	\$1.11	\$1.11
Production - Sherwood							
Copper	46.8	62.0	62.1	62.4	59.1	57.3	57.3
Gold	24.2	30.1	24.0	19.4	24.1	21.2	21.2
Silver	160.3	358.1	312.6	221.9	306.9	222.0	222.0
Cash Cost	\$1.24	\$1.00	\$1.01	\$1.09	\$1.21	\$1.22	\$1.22
Production - Capstone							
Copper	27.4	37.3	37.3	37.3	37.3	37.3	37.3
Zinc	11.7	13.7	13.7	13.7	13.7	13.7	13.7
Lead	3.8	4.4	4.4	4.4	4.4	4.4	4.4
Silver	1.1	1.2	1.2	1.2	1.2	1.2	1.2
Cash Cost	\$0.77	\$0.98	\$0.99	\$0.97	\$0.97	\$0.97	\$0.97
Production - Combined							
Copper	74.2	99.3	99.4	99.7	96.4	94.6	94.6
Zinc	11.7	13.7	13.7	13.7	13.7	13.7	13.7
Lead	3.8	4.4	4.4	4.4	4.4	4.4	4.4
Gold	24.2	30.1	24.0	19.4	24.1	21.2	21.2
Silver	161.3	359.3	313.8	223.2	308.2	223.3	223.3
Cash Cost	\$1.07	\$0.99	\$1.00	\$1.04	\$1.12	\$1.12	\$1.12
Combined Income Statement							
Net Income (C\$m)	96.7	48.6	45.4	43.5	30.6	30.3	29.1
Per Share (FD)	\$0.58	\$0.29	\$0.27	\$0.26	\$0.18	\$0.18	\$0.18
Cash Flow (C\$m)	104.9	58.2	56.1	55.2	43.7	43.2	41.9
Per Share (FD)	\$0.63	\$0.35	\$0.34	\$0.33	\$0.26	\$0.26	\$0.25
Debt Issuance (C\$m)	(72.4)	(20.9)	(7.8)	0.0	0.0	0.0	0.0
Capex (C\$m)	(3.5)	(3.6)	(3.0)	(6.0)	(2.0)	(2.0)	(2.0)
Free Cash Flow	29.0	33.7	45.2	49.2	41.7	41.1	39.9
Shares o/s FD (mm)	165.5	165.5	165.5	165.5	165.5	165.5	165.5

Source: Blackmont Capital Inc.

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Blackmont Research Disclosure

Company Name	Ticker	Disclosure
Capstone Mining Corp.	CS - TSX	-

Distribution of Research Ratings (# of Stocks)

BUY	44	39%
Speculative BUY	11	10%
HOLD	38	33%
SELL	4	4%
Other	17	15%
Total	114	100%

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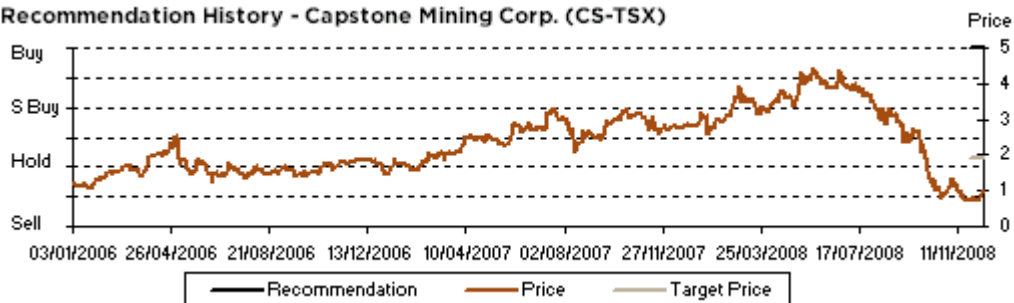
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Recommendation History - Capstone Mining Corp. (CS-TSX)



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- BUY:** The stock's total return is expected to exceed a minimum of 15% over the next 12 months.
- Speculative BUY:** The stock's total return is expected to exceed 30% to 40% over the next 12 months. However, there exists a very high and unquantifiable risk in either the corporate or industry fundamentals associated with the investment that could result in a significant loss.
- HOLD:** The stock's total return is expected to be between 0% and 15% over the next 12 months.
- SELL:** The stock's total return is expected to be negative over the next 12 months.
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