

Hudbay Minerals Inc.

(HBM-T: C\$8.81)

BUY, High Risk

Dundee target: C\$10.00

Augusta Resource Corp.

(AZC-T: C3.29)

TENDER, High Risk

Dundee target: N/A

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AZC-HBM Transaction Update - Next Catalyst BCSC Decision

Why We Believe AZC's Shareholders Should Tender

In light of the upcoming BC Securities Commission (BCSC) decision on the validity of AZC's shareholder rights plan (SRP) we are reiterating our view that AZC shareholders' best option is to tender shares to HBM's offer. Given that the independent third-party proxy advisory firm ISS has issued an opinion against the plan, and that the BCSC has a strong record of turning down rights plans under similar circumstances, we believe it is likely that AZC's poison pill will be rejected which would allow AZC shareholders the freedom to tender to HBM's offer.

We are reiterating our Buy rating and \$10.00/share target price for HBM and our Tender recommendation for AZC.

We believe the offer should be looked upon favorably, by owners of HBM and AZC

HBM makes a strong case for the takeover. Our thesis remains that AZC's permitting timeline is still uncertain in the face of significant environmental and social headwinds. We agree with HBM that they are "...better positioned than Augusta to advance the Rosemont project through the final stages of permitting and into construction".

AZC has liquidity issues and limited financial capacity to build Rosemont. Should HBM's offer not be accepted, we believe that AZC would be forced to finance from a position of weakness, resulting in substantial shareholder dilution.

HBM: Price/Volume Chart



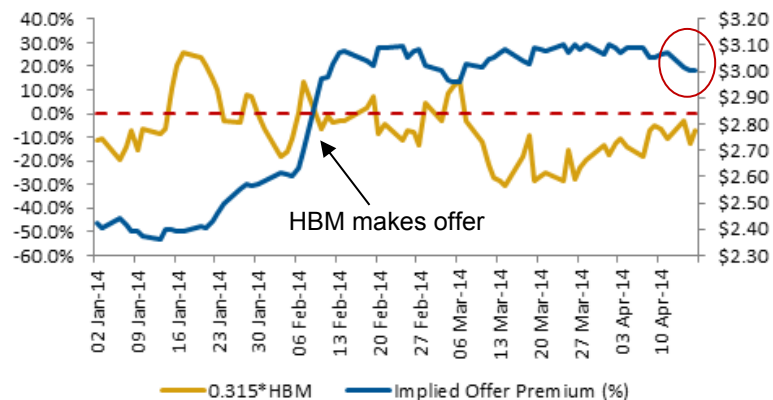
Source: Factset

AZC: Price/Volume Chart



Source: Factset

AZC's Implied Takeover Premium Compared to HBM Offer of 0.315 HBM/AZC



Source: Hudbay Minerals

We believe that if AZC were to fall to pre-offer levels, the stock could experience over 30% downside after the HBM offer expires.

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Why We Believe AZC's Shareholders Should Tender

BOTTOM LINE: AZC SHAREHOLDERS SHOULD TENDER

We believe that the BCSC will rule against the validity of AZC's poison pill. Once the poison pill is removed AZC shareholders will be able to tender to HBM's offer. We believe that tendering to the Hudbay offer is AZC's best option at this time.

TIMELINE AND BACKGROUND - WHAT AZC'S POISON PILL MEANS FOR HBM'S OFFER

- **April 18, 2013:** AZC's board approves a shareholder rights plan ("poison pill") that allows existing holders to acquire shares at a prohibitive discount to market prices if an acquirer surpasses a 15% ownership threshold.
- **October 17, 2013:** ISS, an independent organization that provides a proxy advisory service comes out with a recommendation against AZC's shareholder rights plan.
- **February 9, 2014:** HBM submits a takeover bid of 0.315 HBM shares for each AZC share.
- **April 8, 2014:** AZC announces that it has advanced to May 2, 2014 the date of its previously-scheduled annual shareholder meeting to re-affirm its shareholder rights plan via a shareholder vote.
- **April 14, 2014:** HBM applies to the BC Securities Commission ("BCSC") for a Cease Trade Order concerning AZC's poison pill. HBM notes that sufficient time has passed for AZC to seek alternative offers and *"If left in place, the Augusta Poison Pill will further entrench this management team"*.
- **Expected May 1, 2014:** We expect the BCSC will rule on AZC's shareholder rights plan shortly before the company's proposed shareholder vote.
- **Expected May 2, 2014:** AZC shareholders hold their shareholder meeting at which time they (excluding HBM) will vote on whether to maintain the shareholder rights plan. This vote would be rendered obsolete should the BCSC rule against the SRP.
- **Expected May 5, 2014:** HBM's offer for AZC expires. HBM does not intend to extend its offer unless the poison pill is removed.

As long as the poison pill remains in place AZC shareholders do not have the ability tender shares to the HBM offer. We believe that the poison pill has served its purpose by giving AZC time to consider any other forthcoming bids but it now acts as a hindrance, preventing shareholders from tendering to what we at the moment believe is the best (and only) bid.

Augusta has rescheduled its shareholder meeting (and the poison pill vote) in tight sequence with the BCSC ruling. AZC insider and management ownership (which has been bolstered by the dilutive financings discussed below) will ensure that insiders have a large impact on the outcome of the vote (which HBM is not allowed to take part in).

We note that, should the BCSC rule on the SRP before the AZC shareholder vote, the outcome of the vote will be rendered obsolete. Therefore, if the BCSC rules against AZC's SRP on May 1st as we expect, shareholders would be free to tender to HBM's offer. This is the outcome the looks most likely for now, supporting our view that the HBM bid will likely succeed.

WHY WE BELIEVE THE BCSC WILL RULE AGAINST THE POISON PILL

We expect the BCSC will make its ruling on AZC's shareholders rights on May 1st, one day before AZC's shareholder vote. We believe that the commission is likely to rule against the validity of the poison pill as it has regularly done so in the past under similar circumstances.

Below we provide a list of recent shareholder rights plans that have been removed by the BCSC. We note that the commission's reasons for rejection can largely also be applied to AZC's situation with regards to the HBM bid.

BCSC Regularly Rejects Shareholder Rights Plans Supporting Shareholders' Ability to Measure the Merits of a Transaction for Themselves

Target	Acquirer	Date	Comission	Decision	Reason
Argentina Gold	Barrick	28-Jan-99	BCSC	Removed	Poison pill introduced too late in process and would interfere with shareholders' ability to decide for themselves if the ABX bid was adequate.
Second Cup	Cara Operations	1-Nov-01	OSC	Removed	
Falconbridge	Xstrata	17-May-06	OSC	Removed	
Meridian Gold	Yamana Gold	26-Jun-07	OSC	Removed	
Lions Gate Ent.	Icahn Group	27-Apr-10	BCSC	Removed	Poison pill exhausted its usefulness and shareholders were being deprived of their ability to respond to the Icahn bid.
Fibrek	Resolute Forest	15-Dec-11	OSC	Removed	
Petaquilla Minerals	Inmet	31-Oct-12	BCSC	Removed	No evidence of alternative bid.
KEYreit	Huntington Capital	29-Jan-13	OSC	Removed	
Aurizon Mines	Alamos Gold	18-Feb-13	BCSC	Removed	No evidence of alternative bid other than Hecla transaction.

Source: BCSC, OSC, Hudbay Minerals, DCM

Further, ISS, an independent organization that provides proxy advisory services came out with a recommendation against AZC's shareholder rights plan in October 2013. ISS specifically highlights the 15% triggering threshold as "unacceptably low" and also notes that:

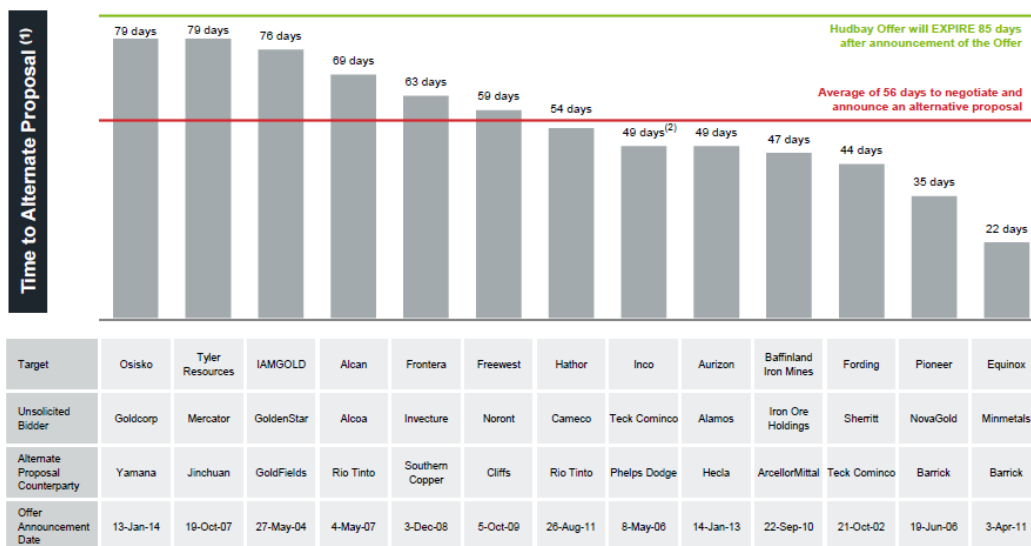
Many Canadian companies have recently adopted rights plans which address the concerns of institutional investors by, among other things, providing for three-year sunset provisions and allowing partial bids to proceed despite board opposition. These "new generation" plans ensure that in a takeover bid situation the board has limited discretion to interpret and administer the plan and shareholders receive fair and equal treatment.

ISS does not consider AZC's plan to be a "new generation" plan

If there was another offer we would have seen it by now...It's been over two months

It has been over two months since the announcement of Hudbay's offer and AZC has been unable to present a competing proposal despite management stating that 10 parties have been conducting extensive due diligence with access to the company's data room. We believe any interested party would likely have acted by now. The following figure shows that, on average, it takes 56 days for companies to negotiate and announce an alternative proposal. When HBM's offer expires on May 5th, more than 85 days will have passed since the initial bid was made. If Augusta believed that its strategic review process would result in an alternative transaction, it would not need to rely on its rights plan as a means of preserving the status quo.

Precedent Unsolicited Mining Transactions with a Negotiated Alternative Proposal



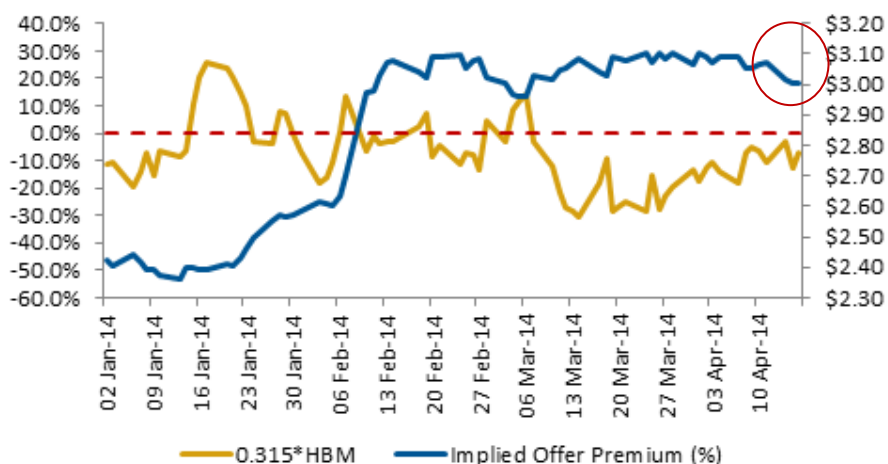
Source: Hudbay Minerals

Implied Premium at Month Low - If HBM offer expires AZC could see large downside

The figure below shows that the implied takeout premium associated with Hudbay's offer has come down over the last couple of days. Historically the premium averaged roughly 25% but now sits at below 20%. We believe the market may start to anticipate that either:

- 1) The poison pill will be removed by the BC Securities Commission and Augusta's shareholders will tender to Hudbay.
- 2) If another bidder comes in, the new offer is unlikely to be at a substantial premium to HBM's initial offer's valued at \$2.96/sh (now at \$2.80).
- 3) If shareholders do not tender, in the absence of another bid, Augusta's stock could decline sharply on liquidity and dilution concerns.

AZC's Implied Takeover Premium Compared to HBM Offer of 0.315 HBM/AZC



Source: Hudbay Minerals

We believe that if AZC were to fall to pre-offer levels, the stock could experience over 30% downside after the HBM offer expires.

WE ARE WORRIED ABOUT ANOTHER DILUTIVE FINANCING IF HBM'S BID IS NOT ACCEPTED - AZC MANAGEMENT HAS A RECORD OF HIGH-COST FINANCINGS

If the HBM bid falls through, AZC will be forced to raise a substantial amount of funds in order to repay Red Kite and to continue with permitting and project development. In the absence of HBM's offer these funds will have to be raised from a position of significant weakness and could be substantially dilutive to project value. Below we highlight AZC's record of high-cost financings.

The **Red Kite financing**, with its recourse on the project, is just one example of how AZC management has arguably reduced shareholder value. Red Kite was given security on Rosemont along with their (in total) ~\$110M loan to AZC. The loan bears interest of LIBOR+4.5% and is accompanied by an offtake agreement for 20% of Rosemont's concentrate. AZC does not provide the terms for the offtake portion of the deal. Given what we believe is a low interest rate on the debt portion, in our opinion the offtake agreement may specify punitive TC/RC terms which would supplant what may have been advantageous TC/RC terms given Rosemont's high quality (projected to be >30% Cu) concentrate. It is also conceivable that the offtake agreement includes more onerous terms such as a possible "look-back" pricing provision whereby Red Kite could essentially have optionality to choose which period of time, within a given range, will determine the settlement price for each delivery. This supports our opinion that AZC management never intended to operate the project, and it is our belief this method of financing may be a way of showing shareholders an ability to borrow at a low rate while foregoing disclosure of the more punitive aspects of the deal.

In 2010 AZC sold all upside on Rosemont's precious metals production to Silver Wheaton in a **streaming agreement**. AZC agreed to sell life of mine gold and silver production to SLW, at \$450/oz Au and \$3.90/oz Ag, for an up-front payment of \$230M (contingent on final permits). Based on DCM's precious metals price deck, **we estimate that the total cost of capital of the Silver Wheaton Streaming deal is 24.5%**. We note that, if HBM comes to own Rosemont it could be a positive for Silver Wheaton given the pre-existing relationship between the companies (PM streams at Constanca and 777).

In Augusta's Q2/13 results released in August 2013, the company announced an agreement with two existing major shareholders (one an officer and one a director) for the issuance of \$10MM in **convertible notes**; this offer was a private placement and was not extended to shareholders in general. We believe that these funds were necessary to bolster AZC's cash position as the company was running out of cash. The \$10MM was raised through convertible, unsecured, notes with a 5-year maturity at an annual interest rate of 7%. The notes are convertible at a 30% premium to the 5-day prior VWAP. **We estimate that the total cost of capital of this insider-based financing was over 11%, and it resulted in ~2% dilution to the remaining shareholders.**

We also note that fully 70% of Rosemont's copper concentrate is spoken for in **offtake agreements** with LGI/KORES (30%), Aurubis (20%), and including Red Kite's share (20%). Although offtake agreements have been set at market rates, set rates could ensure any possible premiums (for what is projected to be a high-quality concentrate produced at Rosemont) may not be realized.

Why we believe Rosemont fits with HBM - Right Project, Right Timing

We believe HBM can afford Rosemont to be delayed, while Augusta can not

We present the following justifications for HBM's timing on the offer:

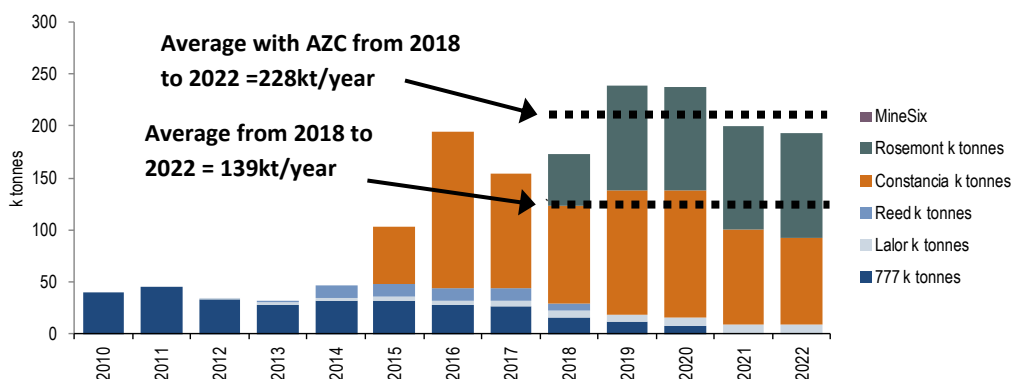
- (1) With the liquidity risk for Augusta, HBM might have decided to make a move in order to prevent Rosemont from falling into Red Kites' hands.
- (2) Alternatively HBM has noted that their project teams at Lalor and Constancia will be done very soon with their work at these projects and will need another project to focus on.

Either way, HBM noted that they are "...better positioned than Augusta to advance the Rosemont project through the final stages of permitting and into construction" and we believe this is true. What's more, we believe HBM can afford Rosemont to be delayed by permitting issues, while Augusta cannot.

Under Hudbay Rosemont's Start Could fit Nicely Between 2016 and 2018

Accounting for some permitting delays, we believe that Rosemont's construction could start somewhere in 2016 and with a two-year construction schedule; first production could happen in 2018. This would fit perfectly with HBM's current copper production growth profile as shown in the following figure. The average copper production from 2018 to 2022 would increase from 139kt/year to 228kt/yr once we include the expected production from Rosemont. This would represent a 65% increase.

Hudbay's Pro-Forma Copper Production Schedule



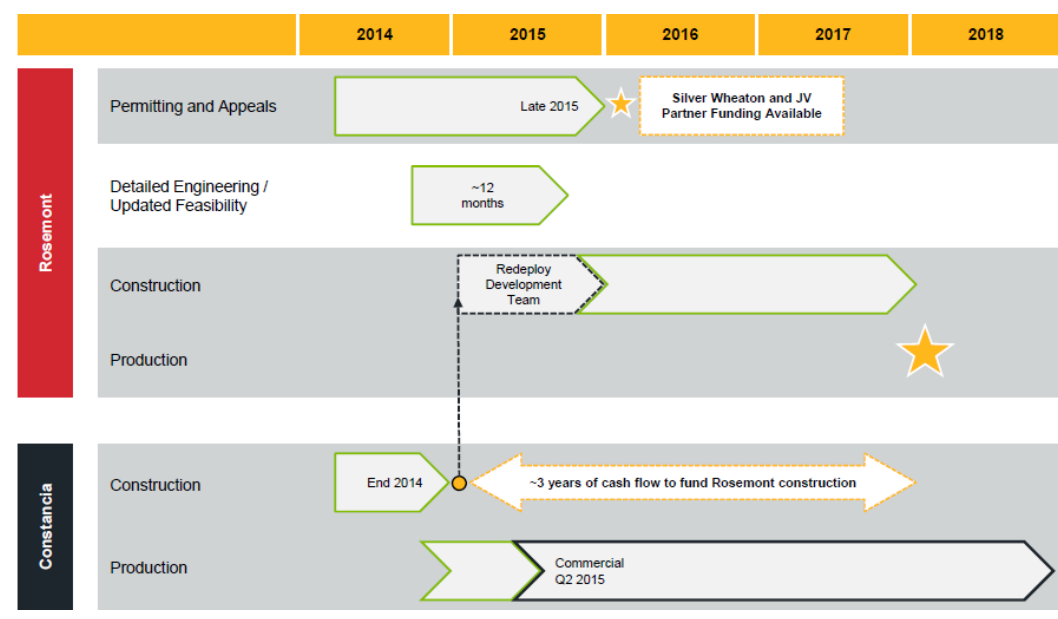
Source: Dundee Capital Market

In terms of capital spending and timing of cash flow, a delayed Rosemont fits right in

To remain conservative we assume construction will not start before mid-2016. That said, we believe that even if it was to start as early as mid-2015 (unlikely), we believe HBM should be able to manage it although the company would have to draw on operating cash flow and in that event the capital situation could be tight.

The following figure shows HBM expected development timeline for Rosemont and Constancia. HBM noted that "Rosemont aligns well with Hudbay's existing development timeline and cash flow". HBM essentially expect roughly 3 years for cash flow from Constancia to fund Rosemont's construction which would start by 2016 with first production in 2018.

Rosemont Development Timeline according to HBM



Source: Hudbay Minerals

As opposed to AZC, HBM can afford to sit on the project if permitting is delayed.

As opposed to Augusta, Hudbay can afford to sit on the project if permitting is delayed. In fact we believe it would probably be better from a cashflow standpoint for HBM. Constancia should start generating significant cashflow in 2016, but this cashflow will be needed to finance the construction of the new concentrator at Lalor. However, starting in 2017 excess cash flow could be used to construct Rosemont. We highlight that by using shares in its all-share offer for Augusta, HBM could actually also strengthen the company's debt/equity ratio. Of additional importance is the fact that HBM will not consume cash. Therefore, by not using cash, we believe there is no rush to finance Rosemont construction and by the end of 2015, once Constancia is largely finished, it might become much easier for HBM to finance Rosemont shall any additional financing be required.

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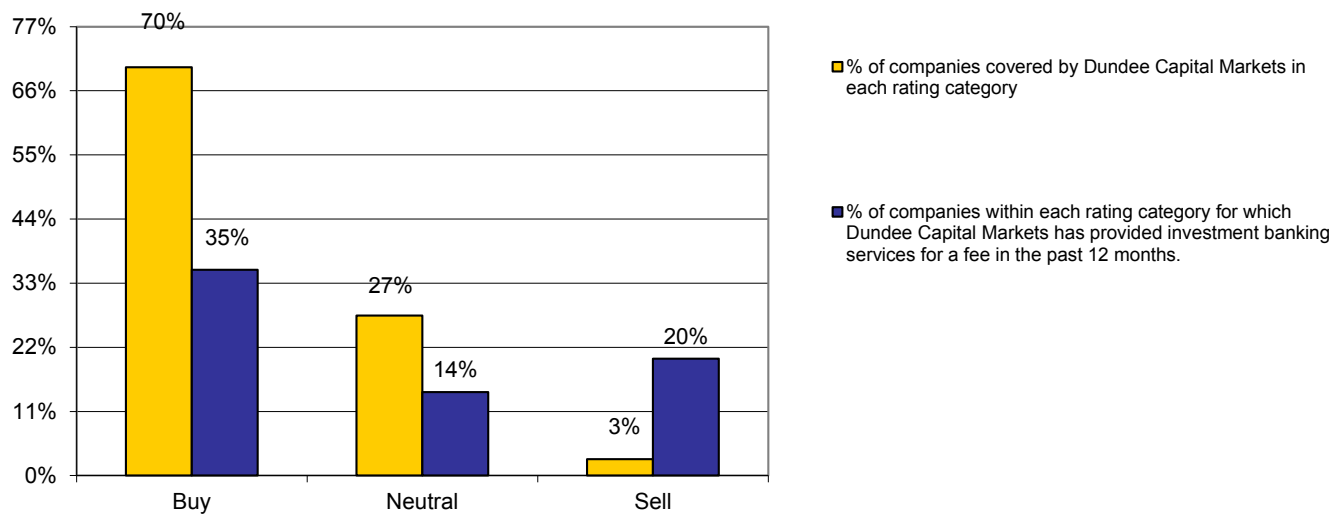
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As at March 31, 2014

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