

# Farallon Mining

(FAN-TSX)

**Stock Rating:** Market Perform(S)  
**Industry Rating:** Market Perform

## Initiating Coverage With Market Perform (Speculative) Rating

### The Company

Farallon Mining (TSX: FAN) is a Vancouver-based mining company listed on the Toronto Stock Exchange. Farallon has one asset, the G-9 mine in Southern Mexico, which was discovered in May 2005 and brought into production in April 2009. Current reserves and resources give G-9 a mine life of less than four years; however, exploration in the area is promising and potential expansion of the G-9 deposit exists if similar local orebodies are discovered. The company has committed to a US\$5.3M mill expansion, which should be completed by July 2010.

### Forecasts

BMO Research forecasts 2010 production of 54.8kt zinc, 6.4kt copper, 20.3koz gold and 2.0Moz of silver. EPS is estimated at US\$0.13/share for 2010 and 2011.

### Valuation

BMO Research estimates an NPV of C\$0.53/share, based on a long-term zinc price of US\$1.00/lb and at a nominal discount rate of 10%.

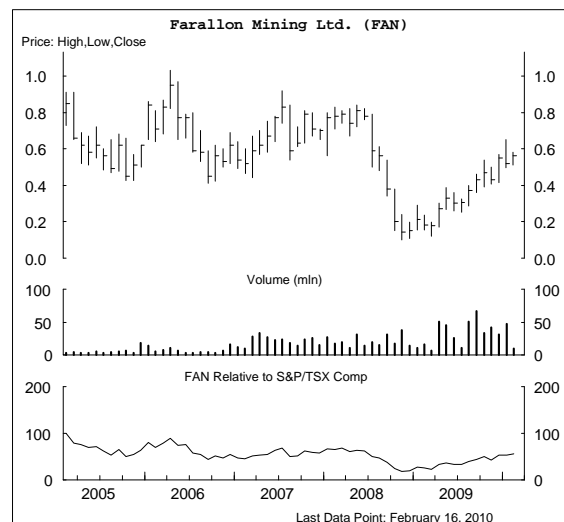
### Recommendation

BMO Research initiates coverage of Farallon with a Market Perform (Speculative) rating and C\$0.60 target price (1.1x NPV). The G-9 mine currently has a relatively short life span, but the continuation of positive drilling results in the Campo Morado area could be a significant catalyst for the stock. Corporately, the company is looking to become a mid-cap company and is considering near-term merger opportunities. Please refer to BMO Research report, "[Zinc Miners – The Forgotten Base Metal?](#)" for further details.

**February 17, 2010**  
 Research Comment  
 London, UK

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**Price (15-Feb)** \$0.56      **52-Week High** \$0.65  
**Target Price** \$0.60      **52-Week Low** \$0.12



(FY-Dec.)	2008A	2009E	2010E	2011E
<b>EPS</b>	-\$0.21	-\$0.01	\$0.13	\$0.13
<b>P/E</b>		na	4.2x	4.3x
<b>CFPS</b>	-\$0.13	\$0.01	\$0.17	\$0.16
<b>P/CFPS</b>		53.1x	3.1x	3.3x
<b>Zinc (US\$/lb)</b>	\$0.86	\$0.75	\$1.10	\$1.20
<b>Copper (US\$/lb)</b>	\$3.16	\$2.34	\$3.30	\$3.70
<b>Gold (US\$/oz)</b>	\$873	\$972	\$1,150	\$1,150
<b>EV/EBITDA</b>	na	na	1.5x	1.2x
<b>Quarterly EPS</b>	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>
<b>2008A</b>	-\$0.04	-\$0.06	-\$0.06	-\$0.05
<b>2009E</b>	-\$0.02	-\$0.02	\$0.00	\$0.02
<b>2010E</b>	\$0.03	\$0.03	\$0.03	\$0.04
<b>Dividend</b>	\$0.00	<b>Yield</b>		0.0%
<b>Book Value</b>	\$0.07	<b>Price/Book</b>		7.6x
<b>Shares O/S (mm)</b>	471.9	<b>Mkt. Cap (\$mm)</b>		\$264
<b>Float O/S (mm)</b>	467.2	<b>Float Cap (\$mm)</b>		\$262
<b>Wkly Vol (000s)</b>	8,323	<b>Wkly \$ Vol (mm)</b>		\$3.2
<b>Net Debt (\$mm)</b>	\$7.7	<b>Next Rep. Date</b>		Mar (E)

**Notes:** Share price, target & cap. in C\$, all others in US\$

**Major Shareholders:**

**First Call Mean Estimates:** FARALLON MINING LTD (US\$) 2009E: -\$0.01; 2010E: \$0.11; 2011E: \$0.19

## Financial Summary

Farallon Mining		FAN TSX	
As at 15-Feb-10 Recommendation	Mkt (\$)	Analyst:	David Cotterell
Share Price (US\$)	\$0.55	Share Price (C\$)	\$0.56
Model Derived Target Value (US\$)	\$0.59	Model Derived Target Value (C\$)	\$0.60
NPV (US\$)	\$0.52	NPV (C\$)	\$0.53
Ordinary Shares (M)	471.7		
Options + Notes (M)			
Market Cap (US\$M)	\$259	Market Cap (C\$)	\$264

PRICE ASSUMPTIONS		(Dec Year End)				
		2009E	2010E	2011E	2012E	2013E
Exchange Rate	C\$/USD	0.88	0.99	0.97	0.95	0.93
Zinc	UScents/lb	75	110	120	100	100
Copper	UScents/lb	234	330	370	350	300
Lead	UScents/lb	78	100	100	80	80
Gold	US\$/oz	972	1150	1150	950	925
Silver	US\$/oz	14.63	20.00	20.00	15.00	14.75

FINANCIAL SUMMARY		(Dec Year End)				
		2009E	2010E	2011E	2012E	2013E
<b>NPAT (pre-Abs)</b>	<b>(US\$M)</b>	<b>-5.4</b>	<b>65.3</b>	<b>63.6</b>	<b>44.8</b>	<b>35.5</b>
EPS	(US\$ps)	-0.01	0.13	0.13	0.09	0.07
PER	(x)	na	4.2	4.3	6.2	7.8
EPS Growth	(%)	94.5	+>100.0	-2.5	-29.6	-20.7
<b>EBITDA</b>	<b>(US\$M)</b>	<b>-4.3</b>	<b>123.9</b>	<b>98.2</b>	<b>67.7</b>	<b>50.8</b>
EBITDA per Share	(US\$ps)	0.0	0.2	0.2	0.1	0.1
EV/EBITDA	(x)	na	1.5	1.2	1.0	0.6
<b>Dividend</b>	<b>(US\$ps)</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Yield	(%)	0.0	0.0	0.0	0.0	0.0
P/FCF	(x)	3.7	3.7	5.0	6.3	23.4
FCF Yield	(%)	27.3	27.1	20.0	15.9	4.3

PROFIT AND LOSS STATEMENT - US\$M		(Dec Year End)				
		2009E	2010E	2011E	2012E	2013E
Sales Revenue		104.7	193.1	203.6	174.5	144.6
Other Revenue		-10.2	0.0	0.0	0.0	0.0
Operating Costs		68.5	78.4	100.5	101.7	88.7
<b>Gross Operating Profit</b>		<b>26.0</b>	<b>114.7</b>	<b>103.1</b>	<b>72.8</b>	<b>55.9</b>
Depreciation		10.8	12.0	10.7	10.7	9.2
Exploration and Royalties		0.5	5.3	1.2	1.2	1.2
Corporate and Other		11.7	4.0	4.0	4.0	4.0
<b>EBIT</b>		<b>3.0</b>	<b>93.5</b>	<b>87.1</b>	<b>56.9</b>	<b>41.5</b>
Less Net Interest Expense		4.0	0.1	-3.6	-7.2	-9.2
<b>Pre-Tax Profits</b>		<b>-1.0</b>	<b>93.3</b>	<b>90.8</b>	<b>64.0</b>	<b>50.7</b>
Less Tax		4.4	28.0	27.2	19.2	15.2
Plus Associates less Divds		0.0	0.0	0.0	0.0	0.0
<b>NPAT (pre-Abs)</b>		<b>-5.4</b>	<b>65.3</b>	<b>63.6</b>	<b>44.8</b>	<b>35.5</b>
Net Abnormals		0.0	0.0	0.0	0.0	0.0
<b>Reported Profit</b>		<b>-5.4</b>	<b>65.3</b>	<b>63.6</b>	<b>44.8</b>	<b>35.5</b>

DIVISIONAL VALUATION		RESERVES & RESOURCES		
NPV US\$M		Contained Metal (kt)	Mine Life (Years)	
Campo Morado	211			
Exploration	63	Zinc Reserves	0	0
Corporate & Other	-21	Zinc Resources	714	10
Net Cash	-8	BMO Guesstimate	561	8
<b>TOTAL NPV (US\$M)</b>	<b>245</b>	Copper Reserves	0	
NPV per Share (US\$)	0.52	Copper Resources	72	
		BMO Guesstimate	63	

CASH FLOW ANALYSIS - US\$M		(Dec Year End)				
		2009E	2010E	2011E	2012E	2013E
<b>Cash Flows From Operating Activities</b>						
Receipts From Customers		94.5	193.1	203.6	174.5	144.6
Payments To Suppliers		(80.3)	(83.7)	(104.5)	(105.7)	(92.7)
Net Interest		(4.0)	(0.1)	3.6	7.2	9.2
Tax and Other		(4.4)	(28.0)	(27.2)	(19.2)	(15.2)
<b>Cash Flows From Investing Activities</b>						
Acq. of Property, Plant and Equip.		(13.5)	(9.3)	(4.0)	(4.0)	(4.0)
Exploration Expenditure		0.0	0.0	0.0	0.0	0.0
Other		0.0	0.0	0.0	0.0	0.0
<b>Cash Flows From Financing Activities</b>						
Net Change in Borrowings		0.6	(5.0)	(10.0)	(10.0)	(1.5)
Dividends Paid		(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Other		26.2	0.0	0.0	0.0	0.0
<b>Net Increase In Cash Held</b>		<b>19.1</b>	<b>67.0</b>	<b>61.5</b>	<b>42.7</b>	<b>40.4</b>
Cash At End of Year		33.2	100.3	161.7	204.5	244.9

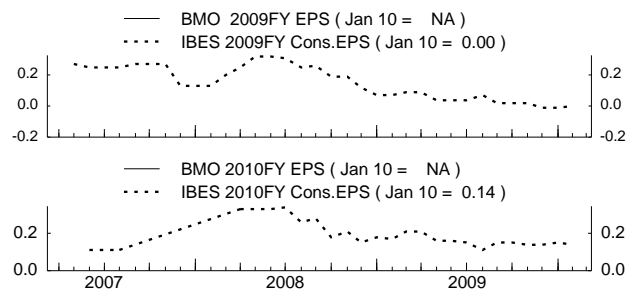
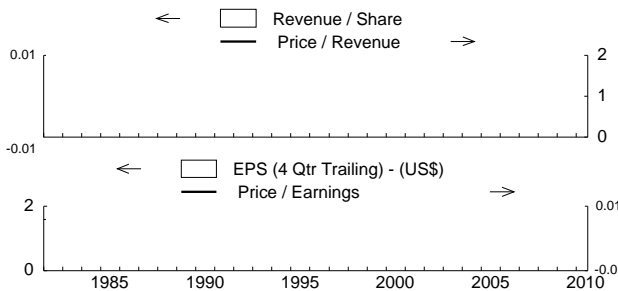
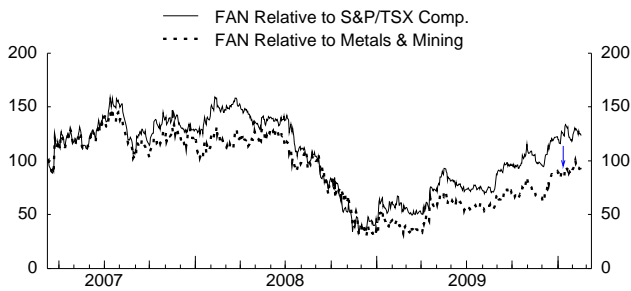
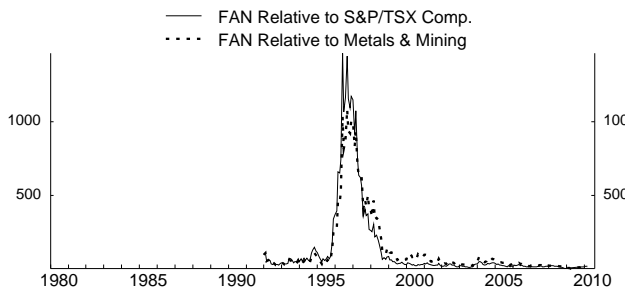
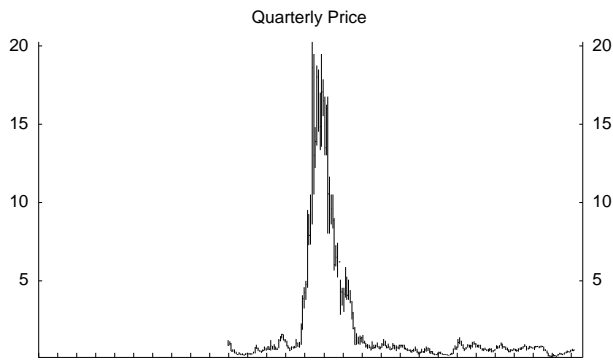
BALANCE SHEET ANALYSIS - US\$M		(Dec Year End)				
		2009E	2010E	2011E	2012E	2013E
<b>Current Assets</b>						
Cash and Liquids		33.2	100.3	161.7	204.5	244.9
Other		17.6	17.6	17.6	17.6	17.6
<b>Non-Current Assets</b>						
Investments		0.0	0.0	0.0	0.0	0.0
Fixed Assets		130.1	123.4	115.4	107.5	101.1
Other		0.0	0.0	0.0	0.0	0.0
<b>Current Liabilities</b>						
Borrowings		0.0	0.0	0.0	0.0	0.0
Creditors		17.7	17.7	17.7	17.7	17.7
Other		0.0	0.0	0.0	0.0	0.0
<b>Non-Current Liabilities</b>						
Borrowings		26.5	21.5	11.5	1.5	0.0
Other		160.0	160.0	160.0	160.0	160.0
<b>Minority Interest</b>		<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>SHAREHOLDERS FUNDS</b>						
Net Cash / (Net Debt)		55.3	120.6	184.2	229.0	264.5
		6.7	78.8	150.2	203.0	244.9
<b>Net Debt/Equity %</b>		<b>-12.2</b>	<b>-65.3</b>	<b>-81.6</b>	<b>-88.6</b>	<b>-92.6</b>

DIVISIONAL EARNINGS (EBIT) - US\$M		(Dec Year End)				
		2009E	2010E	2011E	2012E	2013E
Campo Morado		14.7	97.5	91.1	60.9	45.5
Corp and Other		-11.7	-4.0	-4.0	-4.0	-4.0
<b>Total</b>		<b>3.0</b>	<b>93.5</b>	<b>87.1</b>	<b>56.9</b>	<b>41.5</b>
<b>FINANCIAL RATIOS</b>						
ROA	(%)	1.6	38.7	29.6	17.3	11.4
ROE	(%)	NM	54.2	34.5	19.6	13.4
ROIC	(%)	3.6	65.8	44.5	24.7	15.7

PROJECT/DIVISION		2009E 2010E 2011E 2012E 2013E				
Zinc Payable	kt	32.4	46.5	45.0	45.0	38.7
Copper Payable	kt	3.1	6.1	5.3	5.3	4.6
Lead Payable	kt	0.4	0.0	0.0	0.0	0.0
Gold Payable	oz	14909	18229	20834	20834	17940
Silver Payable	koz	1178	1924	2199	2199	1894
<b>Zn Equivalent Production</b>	<b>kt</b>	<b>61.9</b>	<b>89.2</b>	<b>87.0</b>	<b>87.4</b>	<b>72.6</b>
Zn Cash Cost (Co- Product)	(US\$/lb)	0.43	0.40	0.52	0.53	0.55
Zn Cash Cost (By- Product)	(US\$/lb)	0.12	-0.02	0.16	0.27	0.35

Source: BMO Capital Markets

### Farallon Mining Ltd. (FAN)



FYE (Dec.)	EPS US\$	P/E	DPS \$	Yield %	Payout %	BV \$	P/B	ROE %
1991		nm	0.00	ND	nm	ND	nm	nm
1992		nm	0.00	ND	nm	ND	nm	nm
1993		nm	0.00	ND	nm	ND	nm	nm
1994		nm	0.00	ND	nm	ND	nm	nm
1995		nm	0.00	ND	nm	0.02	nm	nm
1996		nm	0.00	0.0	nm	1.71	9.6	nm
1997		nm	0.00	0.0	nm	1.71	2.5	nm
1998		nm	0.00	0.0	nm	2.98	0.5	nm
1999		nm	0.00	0.0	nm	2.98	0.2	nm
2000		nm	0.00	0.0	nm	2.98	0.3	nm
2001		nm	0.00	0.0	nm	2.98	0.1	nm
2002		nm	0.00	0.0	nm	2.98	0.1	nm
2003		nm	0.00	0.0	nm	2.98	0.2	nm
2004		nm	0.00	0.0	nm	2.98	0.3	nm
2005		nm	0.00	0.0	nm	2.98	0.2	nm
2006		nm	0.00	0.0	nm	2.98	0.2	nm
2007		nm	0.00	0.0	nm	2.98	0.2	nm
2008		nm	0.00	0.0	nm	2.98	0.1	nm
Current*	NC	nm	0.00	0.0	nm	0.07	7.0	nm
Average:				0.0			1.1	
Growth(%):								
5 Year:	nm		nm			-52.2		
10 Year:	nm		nm			-30.8		

\* Current EPS is the 4 Quarter Trailing to Q3/2009.

FAN - Rating as of 8-Mar-07 = Und.(S)

Date	Rating Change	Share Price
1 12-Jan-10	Und.(S) to NR	\$0.57

Last Daily Data Point: February 16, 2010

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I, David Cotterell, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities or issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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**Methodology and Risks to Price Target/Valuation**

**Methodology:** The target price is derived using a weighted blend of NPV, EBITDA multiples, growth factors and mine life.

**Risks:** FAN's earnings are highly levered to the price of zinc which can be very volatile. The company is subject to foreign exchange risk and country risk, as the company reports in U.S. dollars but its primary operations are located in Mexico. FAN's G-9 mine has a limited life of around four years. BMO Research derives ~25% of FAN's valuation from the resources of Campo Morado deposit. Non-materialization of exploration at Campo Morado resources may impact valuation and long-term growth of FAN.

**Distribution of Ratings (Dec. 31, 2009)**

Rating Category	BMO Rating	BMOCM US Universe*	BMOCM US IB Clients**	BMOCM US IB Clients***	BMOCM Universe****	BMOCM IB Clients*****	First Call Universe
Buy	Outperform	32.2%	12.3%	38.3%	36.1%	47.9%	50%
Hold	Market Perform	62.6%	10.2%	61.7%	56.9%	48.9%	43%
Sell	Underperform	5.3%	0%	0%	6.9%	3.2%	7%

\* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.

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**Ratings and Sector Key**

We use the following ratings system definitions:

OP = Outperform - Forecast to outperform the market;

Mkt = Market Perform - Forecast to perform roughly in line with the market;

Und = Underperform - Forecast to underperform the market;

(S) = speculative investment;

NR = No rating at this time;

R = Restricted – Dissemination of research is currently restricted.

Market performance is measured by a benchmark index such as the S&P/TSX Composite Index, S&P 500, Nasdaq Composite, as appropriate for each company. BMO Capital Markets eight Top 15 lists guide investors to our best ideas according to different objectives (Canadian large, small, growth, value, income, quantitative; and US large, US small) have replaced the Top Pick rating.

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