RJ INSIGHT

OCTOBER 16, 2009

Farallon Mining Ltd.

FAN-TSX

Increasing Estimates Based on Planned Expansion

Event

We have updated our model after the closing of Farallon's recent C$11.5 mln equity financing, and based on the company's planned expansion at G-9.

Action

We recommend buying Farallon's shares. In our view, the shares are attractive due to growth opportunities from a planned production expansion as well as potential upside from exploration. We have increased our NAV per share estimate to C$0.86 from C$0.70, and our target price to C$0.55 from C$0.45.

Analysis

- **Use of proceeds** – Farallon intends to use the net proceeds from the equity financing to resume exploration at its Campo Morado property, and to expand the mill at its G-9 mine to 2,000 tpd from 1,500 tpd.
- **Adjustments to our estimates** – We have updated our model to reflect the share dilution from the equity issuance, an increase in our mill throughput assumption to 2,000 tpd from 1,500 tpd by mid-2010, 3Q09 actual commodity prices, and the revised C$/US$ RJ forecast of $1.10 (prev. $1.18). Our revised EPS estimates for 2009E, 2010E, and 2011E are US$0.00 (prev. US$0.01), US$0.19 (prev. US$0.15), and US$0.14 (prev. US$0.08), respectively. We have increased our zinc production forecast for 2010E and 2011E to 46,400 tonnes and 53,100 tonnes (prev. 40,500 tonnes and 38,700 tonnes, respectively).
- **Potential upcoming catalysts** – 1) The company intends to resume exploration in 4Q09; 2) Farallon expects to complete a preliminary economic assessment on the satellite deposits north of G-9 in 1Q10; and 3) the company is ramping-up production at the G-9 mine, and plans to increase production through an expansion in milling capacity to 2,000 tpd from 1,500 tpd by mid-2010.

Valuation

Farallon's shares trade at a P/NAV of 0.50x. This compares to the weighted average of base metal producers of 0.84x. Our target price of C$0.55 is based on a 0.60x multiple applied to our NAV of C$0.86 per share (in-line with risk and liquidity-adjusted historic producer multiples).

MINING: BASE METALS & MINERALS

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RATING & TARGET

RATING	OUTPERFORM 2 =
Target Price (6-12 mths) (C$)	0.55 ↑
Closing Price (C$)	0.43
Total Return to Target	28%

MARKET DATA

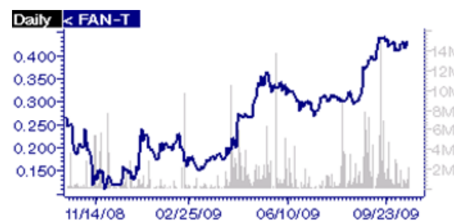
Market Capitalization (US$mln)	181
Current Net Debt (US$mln) (2Q09A)	16
Enterprise Value (US$mln) (2009E)	197
Basic Shares Outstanding (mln)	463.6
Avg Daily Dollar Volume (3mo, mln)	n/a
52 Week Range (C$)	$0.10 - $0.46

KEY FINANCIAL METRICS

FY-Dec 31	2008A	2009E	2010E
EPS (US$)	-0.22	0.00	0.19
P/E (x)	nmf	nmf	2.0
EPS - 1Q (US$)	nmf	-0.02	0.05
EPS - 2Q (US$)	nmf	-0.02	0.05
EPS - 3Q (US$)	nmf	0.01	0.05
EPS - 4Q (US$)	nmf	0.02	0.05
NAVPS (C$)		0.86	
P/NAV(x)		0.50	
Revenue (US$mln)	nmf	74	172
EBITDA (US$mln)	nmf	24	118

COMPANY DESCRIPTION

Farallon Mining Ltd. (FAN-TSX) owns 100% of the high-grade polymetallic mineral concessions at the Campo Morado property in Mexico. The company's G-9 mine at Campo Morado is ramping-up production, and uses conventional flotation to produce zinc, copper, and lead concentrates with significant gold and silver content.



Sources: Raymond James Ltd., Thomson ONE

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Upcoming Catalysts Keep the Focus on Growth

We maintain our positive outlook on Farallon's shares. The company has a number of upcoming initiatives which we expect will continue to act as positive catalysts for the stock. We anticipate the following future catalysts:

- **Resumption of exploration** – We expect Farallon to resume exploration drilling in 4Q09. In an October 8, 2009 press release the company stated that it will spend approximately US$2.7 million on a 20,000 metre drilling campaign over the next two quarters. We expect that the company's first order of business will be to drill prospective targets in the area around G-9 as a first step towards increasing the resource tonnage. We anticipate drilling adjacent to the North Zone, and at the horizon of the Abajo Zone (the North and Abajo Zones are two of the three significant areas comprising the G-9 mineral resource). We note that Farallon's last drilling program, in 2008, did meet with success as it discovered a new sulphide lens called the West Extension (northwest of the North Zone and closer to the San Augustin decline ramp), and it extended the Abajo Zone to the north and the North Zone to the west. The Western Extension area has already provided feed for the mill. Previous drilling has also found indications of deeper mineralization in the Abajo Zone.
- **Preliminary economic assessment (PEA) for satellite deposits at G-9** – Farallon is currently in the process of preparing a PEA on the El Largo, Naranjo, Reforma, and El Rey deposits at Campo Morado. These deposits are located north of the operating G-9 mine, and could potentially leverage the existing mill infrastructure to extend the mine life. The El Largo deposit is expected to be accessible from the existing underground workings with approximately 500 metres of further development, while the other deposits are within roughly 5 km of the mill. We estimate a value of US$56 million in value to the potential of these deposits (C$0.12 per share of our C$0.86 net asset value per share).
- **Increasing production by expanding the mill** – Farallon is presently ramping-up production at the G-9 mine to the design capacity of 1,500 tonnes/day. The company is planning to increase the throughput rate to 2,000 tonnes/day by mid-2010. We provide more detail on this expansion in the following section.

Expected Expansion of the G-9 Mill to 2,000 Tonnes/Day

The expected expansion of the mill to a throughput rate of 2,000 tonnes/day from 1,500 tonnes/day primarily involves an investment in the regrind capacity of the bulk circuit, as well as extra flotation capacity to the bulk and zinc rougher circuits. From our understanding, the existing crushing and primary grind capacity is sufficient to support the higher throughput rates. The original construction of the plant was designed to accommodate for an expansion to the regrind stage, and the concrete foundation is already in place. We have assumed a capital cost of US$10 million for the expansion, at the high end of preliminary management estimates of US$5 million to US$10 million. Farallon has initiated the engineering work for the expansion and plans to begin the installation of the additional components in 2Q10. Our zinc production forecast remains unchanged for 2009E at 35,300 tonnes, but we have increased our estimates for 2010E and 2011E to 46,400 tonnes (previously 40,500 tonnes), and 53,100 tonnes (previously 38,700 tonnes), respectively. We have assumed a 9% reduction in operating costs on a per tonne basis following from the expected economies of scale with spreading fixed costs over the 33% increase in throughput. The company’s recent equity financing and our expectation for improving cash flow should, in our view, provide adequate balance sheet strength to ensure that the company does proceed with the expansion.

Changes to our Estimates

We have increased our NAV/share modestly to C$0.86 (previously C$0.70). By our analysis, the positive impact on the time value of cash flows from increasing production by roughly 33% to 2,000 tonnes/day, from 1,500 tonnes/day, more than offsets the dilution from the equity financing (which will partly be used to fund the expansion). The breakdown of our net asset value estimate for Farallon is shown in Exhibit 1.

Exhibit 1: Farallon Mining Net Asset Value Estimate

Farallon Mining Ltd.	Ownership	US$ (mln)	US$/shr	Valuation Basis
Mines				
G-9	100.0%	340.6	0.71	NPV @ 8% Real FY End 2009
Projects				
Other Campo Morado	100.0%	55.6	0.12	NPV @ 8% Real FY End 2009
Other	0.0%	-	0.00	
Other	0.0%	-	0.00	
Other Assets				
Cash and Marketable Securities		40.9	0.08	Balance sheet as at 4Q-09E
Working Cap net of Cash and ST Debt		0.5	0.00	Balance sheet as at 4Q-09E
Options		4.4	0.01	various expiry dates
Debt and Obligations				
Short Term Debt		-	0.00	Balance sheet as at 4Q-09E
Long-term Debt		(29.2)	-0.06	Balance sheet as at 4Q-09E
Corporate SG&A		(32.9)	-0.07	DCF @ 8% Real FY-09E
Deferred Taxes		-	0.00	Balance sheet as at 4Q'-09E
Provision for Contingencies		-	0.00	
NET ASSET VALUE		379.9	**$0.79**	**C$0.86**

Fully Diluted Shares Outstanding 482,709
Basic Shares Outstanding 463,619
Copper: '08A=US$3.16/lb, '09E=US$2.24/lb, '10E=US$3.10/lb, '11E=US$3.23/lb, L-T=US$1.90/lb
Lead: '08A=US$0.95/lb, '09E=US$0.61/lb, '10E=US$0.62/lb, '11E=US$0.62/lb, L-T=US$0.55/lb
Zinc: '08A=US$0.86/lb, '09E=US$0.79/lb, '10E=US$1.30/lb, '11E=US$0.90/lb, L-T=US$0.85/lb
Silver: '08A=US$14.99/oz, '09E=US$13.40/oz, '10E=US$13.75/oz, '11E=US$12.60/oz, L-T=US$11.50/oz
Gold: '08A=US$873/oz, '09E=US$999/oz, '10E=US$1,050/oz, '11E=US$950/oz, L-T=US$800/oz

Source: Raymond James Ltd.

We have updated our model to reflect the share dilution from the equity issuance, an increase in our mill throughput assumption to 2,000 tonnes/day from 1,500 tonnes/day by mid-2010, 3Q09 actual commodity prices, and the revised C$/US$ RJ forecast of $1.10 (previously $1.18). We have made slight decreases to our copper and lead recovery estimates for 2H09. This reflects what is in our minds is the company's key near-term challenge, optimizing the metallurgical performance of the mill, in particular with respect to the re-use of process water. Our revised EPS estimates for 2009E, 2010E, and 2011E are US$0.00 (previously US$0.01), US$0.19 (previously US$0.15), and US$0.14 (previously US$0.08), respectively. We have increased our zinc production forecast for 2010E and 2011E to 46,400 tonnes and 53,100 tonnes (previously 40,500 tonnes and 38,000 tonnes, respectively). The summary of the changes to our forecast are shown in Exhibit 2.

Exhibit 2: Changes to our Forecast

New Estimates	**2008A**	**2009E**	**2010E**	**2011E**
Zinc Production (tonnes)	0	35,299	46,428	53,060
Zinc Cash Cost (US$/lb)	0.00	0.40	0.01	(0.11)
Total Production Cost (US$/lb)	0.00	0.70	0.20	0.05
EPS Basic (US$)	**(0.22)**	**0.00**	**0.19**	**0.14**
CEPS (US$)	(0.18)	0.04	0.22	0.17
Previous Estimates	**2008A**	**2009E**	**2010E**	**2011E**
Zinc Production (tonnes)	*0*	*35,299*	*40,532*	*38,690*
Zinc Cash Cost (US$/lb)	*0.00*	*0.38*	*0.09*	*(0.02)*
Total Production Cost (US$/lb)	*0.00*	*0.69*	*0.31*	*0.20*
EPS Basic (US$)	***(0.22)***	***0.01***	***0.15***	***0.08***
CEPS (US$)	*(0.18)*	*0.05*	*0.19*	*0.11*
% Change	**2008A**	**2009E**	**2010E**	**2011E**
Zinc Production (tonnes)	N/A	0%	15%	37%
Zinc Cash Cost (US$/lb)	N/A	3%	(84%)	500%
Total Production Cost (US$/lb)	N/A	2%	(33%)	(76%)
EPS Basic (US$)	0%	(89%)	23%	72%
CEPS (US$)	0%	(21%)	18%	50%
Copper Price Forecast (US$/lb)	**3.16**	**2.24**	**3.10**	**3.23**

Source: Raymond James Ltd.

Optimizing Recoveries is the Key Challenge

The G-9 mine is currently ramping-up to its stated pre-expansion design capacity of 1,500 tonnes/day. While mining operations are typically subject to a number of risks, these are heightened and of greater volatility during the ramp-up phase. In our view, the company's key challenge is the metallurgical performance at the plant. In particular, copper recoveries to-date have been lower-than-expected primarily due to the presence of reagents in the process water that is re-circulated into the mill and has suppressed the possible recovery rates. Farallon continues to review alternatives to enhance its process water management in order to improve the recoveries. Options that the company has examined and continues to review include: 1) Diverting process water from the mill to the tailings to limit the amount of reagent recycling, followed by skimming of clean water from the tailings storage facility for processing (a strategy that would require an upgrade to the pumping capacity, but is expected to incur minimal capital costs). This would allow remaining heavy metals in the process water to settle in the tailings pond, and a breakdown of the reagents as they age. 2) Use of the completed water treatment plant to remove cyanide (used to separate the copper and lead). 3) Diversion of thickener overflow back to the rougher flotation circuits to remove more of the contained heavy metals.

Risks

Some of the risk factors that pertain to the projected 6-12 month stock price target for mining companies in our universe are as follows: Mining companies are subject to a range of risks, including, but not limited to: environmental risk, political risk, operational risk, financial risk, hedging risk, commodity price fluctuation risk, and currency risk. Any difference between our metal price forecasts and realized metal prices will likely have an impact on our earnings and valuation estimates for the mining companies in our research coverage universe. The operation of mines, and mills is complex and is exposed to a number of risks, most of which are beyond the company's control. These include: environmental compliance issues, personnel accidents, metallurgical/other processing problems, unexpected rock formations, ground or slope failures, flooding or fires, earthquakes, rock bursts, equipment failures, consultant errors and, interruption due to inclement weather conditions, road closures, and/or local protests. Other risks include, but are not limited to: uncertainties surrounding reclamation costs, aging equipment and facilities which could lead to increased costs, strikes, and transportation disruptions.

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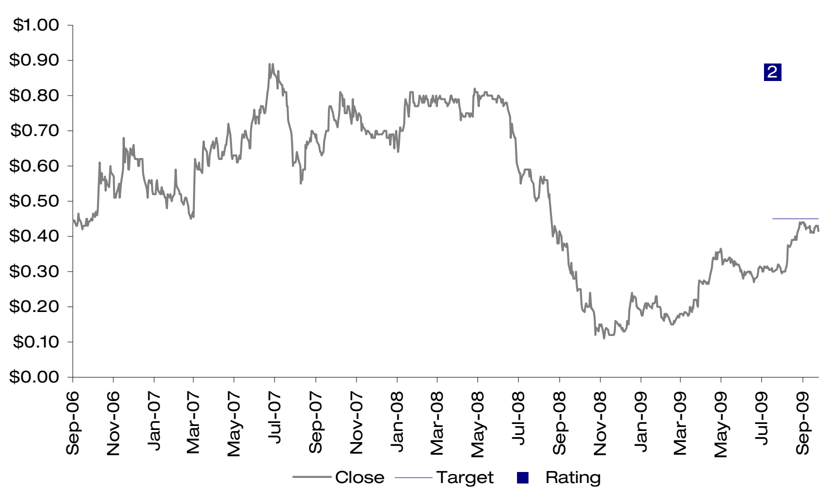
COMPANY	SYMBOL	EXCHANGE	DISCLOSURES
Farallon Mining Ltd.	FAN	TSX	1a, 1b, 6

FARALLON MINING LTD. | FAN-TSX



1-STRONG BUY 2-OUTPERFORM 3-MARKET PERFORM
4-UNDERPERFORM 0-UNDER REVIEW

RATING & TARGET CHANGES

Date	Price	Rating	Target
Aug-05-09	$0.31	2	$0.45