

## Farallon Mining

(FAN-T, \$0.35)

Potential 2<sup>nd</sup> Mine at Campo Morado

### Financial Summary (US\$)

(end-Dec)	Revenue (M)	CFPS	P/CF	EPS	P/E
2009	89.1	-0.01	Nmf	-0.04	Nmf
2010e	179.2	0.13	2.5x	0.11	2.9x
2011e	237.7	0.17	1.9x	0.16	2.1x

All figures in US\$ unless otherwise noted

- ▶ Farallon announced it will undertake a study to construct a mine to exploit the Reforma, Naranjo, El Largo and El Rey deposits adjacent to the Company's existing G-9 mine. Assuming a positive outcome to the study, management would look to have the second operation constructed within 3 years.
- ▶ Additional metallurgical studies at the Reforma, Naranjo, El Largo and El Rey deposits will be key. The mineralization at these deposits is of a different composition and finer grained than at G-9, which may complicate metal recoveries.
- ▶ We view the potential for a second mine as a positive step and low-cost-growth option for Farallon. The proposal for a second mine remains in the conceptual stage and thus we are not altering our financial model at this time. We maintain our \$1.00 target and Buy recommendation.

### 2<sup>nd</sup> Mine Proposed for Campo Morado

Farallon is formally initiating studies to assess the feasibility of building a second mine near its existing G-9 mine. The Company will re-evaluate the Reforma, Naranjo, El Largo and El Rey deposits, located within 2 km of the G9 mine. This second mine would utilize some of the infrastructure already in place to add incremental production to the current G-9 operation. Management will initiate the study immediately, and if results are positive it would look to have the second mine commence operations within 3years.

A potential second mine next door to the Company's G-9 mine represents a comparatively low-cost avenue for growth for the Company. The Reforma, El Rey, Naranjo and El Largo deposits are polymetallic in nature, similar to G-9, but occur in a higher stratigraphic layer and are finer grained and of lower grade. Key to the assessment of a potential second mine will be the outcome of additional metallurgical test work on these deposits to be completed over the next 6 to 12 months.

### Stock Rating:

**Buy**

12-month target (C\$)	\$1.00
Potential ROR	185%

### Company Profile

Sector	Base Metals
Ticker	FAN-T
Shares O/S, basic (M)	472.8
Shares O/S, diluted (M)	494.4
Mkt cap, basic (C\$M)	\$165.5
Mkt cap, FD (C\$M)	\$173.0

### Key Metrics

NAV/sh (C\$)	\$0.99
Cash (US\$M)	\$20.9
Debt (US\$M)	\$21.9

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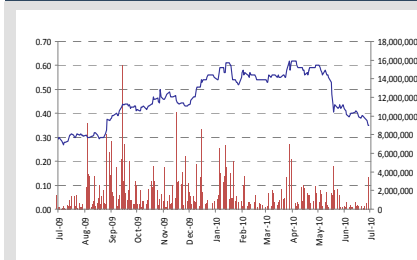
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### 1-Year Stock Chart



04/01/10 Target raised (\$1.00)  
 11/18/09 FY09-10 EPS and target lowered (\$0.75)  
 06/23/09 Target raised (\$0.80)  
 03/14/07 Initiating target price (\$1.10)

Source: Bloomberg

There remains a significant amount of work to define the economic potential for a second mine at Campo Morado. Key design parameters such as processing methodology, deposit sequencing and mining rate have not yet been defined and will be significantly influenced by the results of the pending metallurgical test work. We expect the near-term funding requirements for this study to be minimal - likely less than \$1M.

### **Campo Morado**

The Reforma, El Rey, Naranjo and El Largo deposits were last seriously evaluated in 2005 but were deemed uneconomic at the time owing to substantial initial capital investment, test work indicating low metallurgical recoveries, and the low metal price environment. Management believes that a re-evaluation is warranted now that the nearby G-9 mine has been constructed and commissioned. Much of the necessary basic infrastructure such as road access, power lines, administration offices and a mill are already in place at the nearby G-9 mine and will significantly lower the initial capital requirements for a second mine at Campo Morado. Additionally, commodity prices have significantly increased since 2005, the last time these deposits were seriously studied. The Reforma, El Rey, Naranjo and El Largo deposits contain significant precious metals, including approximately 960koz of gold, which has the potential to significantly improve the economics of a new mine given that the gold price has tripled since these deposits were last studied.

The results of additional metallurgical studies on these deposits will be a major determinant of whether the second mine will proceed. Because of the fine-grained nature of the mineralization, previous test work on these deposits contemplated a hydro-metallurgical extraction process rather than the conventional milling process employed at G-9.

This formal study to assess the feasibility of a second mine is separate from the engineering study announced several months ago, which is contemplating the exploitation of only the higher-grade zinc portions of the El Largo, Naranjo and El Rey deposits using the existing G-9 mining equipment and processing facilities.

### **Maintain Buy Recommendation**

We view the potential second mine at Campo Morado as a positive step in Farallon's growth. The G-9 mine has been demonstrating steady operational improvement since declaring commercial production in April 2009 and is currently achieving mill throughput rates 20-30% above design capacity. With operations progressing well at G-9, management is now in a position to look for the next stage of growth for the Company. The potential to exploit the significant resources in the nearby Reforma, El Rey, Naranjo and El Largo deposits represents a low-cost growth option for the Company that does not put the balance sheet at risk. The relatively small initial financial requirements of this study leave the Company with more than sufficient financial resources to continue its exploration and potential expansion work at the G-9 mine uninterrupted.

We are not making changes to our financial model at this time and maintain both our \$1.00 price target and Buy recommendation.

**Figure 1: Revised Net Asset Value for Farallon**

	<u>US\$ m</u>	<u>C\$ m</u>	<u>C\$/sh</u>
<b>OPERATING ASSETS</b>			
G9 Campo Morado (8%DCR)	\$450.1	\$472.6	\$0.96
Total	\$450.1	\$472.6	\$0.96
<b>OTHER ASSETS</b>			
Working Capital (of which cash is \$20.9m)	\$18.2	\$19.1	\$0.04
Other Properties	\$15.0	\$15.8	\$0.03
Cash from Exercise of Options and warrants	\$6.7	\$7.1	\$0.01
Other Investments (Marketable securities)	\$0.0	\$0.0	\$0.00
Total	\$40.0	\$42.0	\$0.08
<b>TOTAL ASSETS</b>	<b>\$490.1</b>	<b>\$514.6</b>	<b>\$1.04</b>
<b>LIABILITIES</b>			
Long term debt	\$21.9	\$23.0	\$0.05
Convertible Debentures	\$0.0	\$0.0	\$0.00
Environmental/Other	\$0.6	\$0.6	\$0.00
Long term leases	\$0.0	\$0.0	\$0.00
Total	\$22.5	\$23.6	\$0.05
<b>TOTAL LIABILITIES</b>	<b>\$22.5</b>	<b>\$23.6</b>	<b>\$0.05</b>
<b>NET ASSET VALUE</b>	<b>\$467.6</b>	<b>\$491.0</b>	<b>\$0.99</b>
<b><u>Exchange Rate</u></b>			
US\$ /C\$	1.05		
<b><u>Shares Outstanding</u></b>			
			472.8
			4.5
			17.2
			0.0
			494.4

Source: Company, Paradigm Capital

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