

## Farallon Resources

FAN-C\$0.15

Site Visit Confirms that Commissioning Proceeding Well

### Financial Summary (C\$)

(end-Dec)	Revenue (m)	CFPS	P/CF (x)	EPS	P/E (x)
2007	0.1	-0.03	nm	-0.02	nm
2008e	35.9	-0.00	nm	-0.03	nm
2009e	166.2	0.18	0.8	0.16	0.9
2010e	227.8	0.30	0.5	0.29	0.6

All figures in C\$ unless otherwise noted

- Overall, we were very pleased with the site visit. The mill looks excellent and in our opinion should be able to handle well over 1,500 tonnes per day.
- The company appears to be well on its way to achieving throughput of 1,500 tonnes per day in January. Recoveries at the mill are improving daily.
- Our revised NAV is now \$1.04. We are now using a 0.75x NAV to derive our target which is now \$0.75. We are maintaining our Buy recommendation for Farallon Resources.

### G9 Site Visit Update

Earlier this week we visited Farallon's G9 mine in Guerrero State Mexico. Overall, we were very pleased with the site visit. The mill looks excellent and in our opinion it should be able to handle much more than 1,500 tonnes per day. The crusher appears to have over three times the capacity of the mill so the company has begun to build a crushed ore stockpile at grading approximately 10% zinc. Mined grades are reconciling well with the block model, which is good news. Since the beginning of november, the company has been mining an average 9.7% zinc at a throughput rate of approximately 1,000 tonnes per day, which is right in line with the company's targets.

Beginning in December, the amount of required underground development work should fall dramatically. This should allow the company to focus more on mining high grade ore and thereby allow it to reach the targeted mine rate of 1,500 tonnes per day. Throughput for Q1 is targeted at 1,500 tonnes per day grading approximately 14.7% zinc, 2.1% copper, 1.2% lead, 3.25 g/t gold and 225 g/t silver. After seeing the mine from underground, we believe this should definitely be achievable. Throughput for Q2 is targeted at 1,500 tonnes per day grading approximately 11.5% zinc, 1.75% copper, 1.57% lead, 4.0 g/t gold and 300 g/t silver.

### Stock Rating:

**Buy**

12- target (C\$) ↓\$0.75  
 Potential ROR 60%

### Company Profile

Sector	Base Metals
Ticker	FAN-T
Shares O/S, basic (m)	352.8
Shares O/S, diluted (m)	394.1
Mkt cap, basic (C\$m)	52.9
Mkt cap, FD (C\$m)	59.1

### Key Metrics

NAV/sh (C\$)	↓0.78
Cash (C\$)	22.0
Debt (C\$)	32.75

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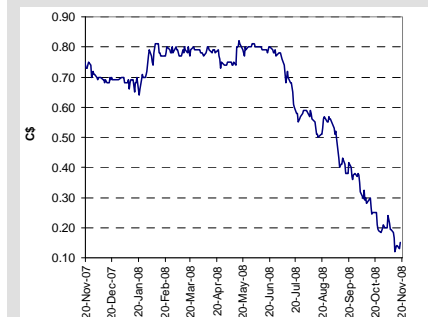
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### 1-Year Stock Chart



11/21/08 Target lowered (\$0.75)  
 10/08/09 Target lowered (\$1.20)  
 05/21/08 FY08/09 EPS lowered, target raised (\$1.25)  
 01/21/08 FY08-09 CFPS & target lowered (\$1.15)  
 03/14/07 Initiating target price (\$1.10)

Source: Bloomberg

The mill has been steadily improving since first producing zinc concentrate in August. Recently, the mill has produced zinc concentrate grading up to 60%, which is world class and far above the target of 54% for the life of the mine. Zinc recoveries have been as high as 95%. The lead concentrate has been above target for some time now and currently contains approximately 300 g/t silver. The copper concentrate has recently improved drastically and it could be grading above 20% by the end of this week. All concentrates are being sold to Trafigura, which is one of if not the largest zinc and lead concentrate trader in the world.

#### **Maintain Buy, Reducing Target Price**

We have made several changes to our model to reflect the financial statements reported earlier this week as well as other operating information we learned from our site visit. We have raised most of our cost assumptions and lowered our expected head grades modestly for 2009. Our estimate of payable zinc production for 2009 is now 123m pounds, which is down from 125m pounds. Our estimated total cost per tonne for 2009 is now \$131, which is up from \$125, which gives us a cash cost per pound net of credits of \$0.16.

Our revised NAV is \$1.04, which is down from \$1.25 due to the drop in working capital and our assumed higher costs for 2009, Figure 1. We have excluded the warrants from our estimates that are due to expire on December 21<sup>st</sup> at a weighted average strike price of \$0.68. Additionally, we have assumed that the company will extend both its corporate notes and its convertible debentures by six months. We have also lowered our assumed prices for gold and silver from \$875 and \$13.50 to \$725 and \$9.55 respectively.

Lately, investors are concerned about falling metal prices and their sensitivity to our companies' net asset values. If we assume metal prices of \$0.50 for zinc, \$1.50 for copper, \$0.40 for lead, \$6.00 for silver and \$725 for gold from 2009 onwards to infinity, our NAV for Farallon would still be \$0.31, which is more than double the current share price. Using these metal prices, Farallon would still generate \$0.06 in fully diluted cash flow after taxes and interest.

We are lowering our target multiple from 1x NAV to 0.75x NAV to reflect the market multiple of Farallon's peers. Therefore, our target is going from \$1.25 to \$0.75. We feel this is still a very low target price since it would only represent 4.2x our CFPS estimate for 2009 of \$0.18 per fully diluted share. We are maintaining our Buy recommendation.

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

	<u>US\$ m</u>	<u>C\$ m</u>	<u>C\$/sh</u>			
<b>OPERATING ASSETS</b>						
G9 Campo Morado (8%DCR)	\$360.4	\$411.9	\$1.05			
Total	\$360.4	\$411.9	\$1.05			
<b>OTHER ASSETS</b>						
Working Capital (of which cash is \$17m)	\$3.1	\$3.5	\$0.01			
Other Properties	\$4.4	\$5.0	\$0.01			
Cash from Exercise of Options and warrants	\$11.1	\$12.7	\$0.03			
Recoverable Mexican Taxes	\$9.6	\$11.0	\$0.03			
Other Investments (Marketable securities)	\$0.9	\$1.0	\$0.00			
Total	\$29.0	\$33.2	\$0.08			
<b>TOTAL ASSETS</b>	<b>\$389.4</b>	<b>\$445.1</b>	<b>\$1.13</b>			
<b>LIABILITIES</b>						
Corporate Notes @ 15%	\$28.6	\$25.0	\$0.06			
Convertible Debentures @ 7.5%	\$8.9	\$7.8	\$0.02			
Environmental/Other	\$1.2	\$1.3	\$0.00			
Long term leases	\$1.4	\$1.6	\$0.00			
Total	\$40.0	\$35.7	\$0.09			
<b>TOTAL LIABILITIES</b>	<b>\$40.0</b>	<b>\$35.7</b>	<b>\$0.09</b>			
<b>NET ASSET VALUE</b>	<b>\$349.4</b>	<b>\$409.4</b>	<b>\$1.04</b>			
<b>Exchange Rate</b>						
US\$ /C\$	1.14					
<b>US\$</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>Longterm</b>	<b>Shares Outstanding</b>	
Zn	\$0.90	\$0.75	\$1.05	\$0.80	Basic	<b>352.84</b>
Cu	\$3.25	\$2.25	\$2.75	\$1.75	Warrants	<b>5.09</b>
Pb	\$0.95	\$0.75	\$0.95	\$0.70	Options	<b>12.70</b>
Ag	\$725	\$725	\$725	\$725	Convertible Debs	<b>23.48</b>
Au	\$5.30	\$5.30	\$5.30	\$5.30	Fully Diluted	<b>394.12</b>

Source : Company, Paradigm Capital

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2. David Davidson does not have an ownership position in Farallon Resources (FAN-T).
3. Michael Bandrowski does not have an ownership position in Farallon Resources (FAN-T).
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