

## Farallon Mining

(FAN-C\$0.56)

Mill Expansion Complete Ahead of Schedule

### Financial Summary (US\$)

(end-Dec)	Revenue (m)	CFPS	P/CF (x)	EPS	P/E (x)
2009	89.1	-0.01	nm	-0.04	nm
2010e	179.2	0.13	4.0	0.11	4.7
2011e	237.7	0.17	5.2	0.16	5.6

All figures in US\$ unless otherwise noted

- ▶ Farallon continues to make progress at G9. Mill throughput has essentially achieved its 2,000tpd expansion target as at the end of the quarter; three months ahead of schedule. Further mill expansions will be studied once additional mine development has been completed.
- ▶ Metallurgical performance continues to improve with zinc and copper recoveries increasing to 82% and 59%, respectively in Q1/10. Q1 average cash costs declined to \$0.38/lb of zinc and were \$0.31/lb for the month of March.
- ▶ Our revised NAV is essentially unchanged at \$0.99. We maintain our \$1.00 target and Buy recommendation.

### Q1 Financials

The G-9 mine produced a record 25mlbs of zinc in the first quarter at an improved cash cost of \$0.38/lb, resulting in gross revenues increasing QoQ to \$37.6m from \$32.3m. Operating earnings increased to \$9.1m (\$0.02/sh), while net earnings increased to \$6.2m (\$0.01/sh). Farallon's balance sheet continues to strengthen with cash on hand at quarter end of \$20.9m, working capital increasing to \$18.2m and long term debt falling to \$21.9m.

### G9 Demonstrating Steady Improvement

Quarterly production at the G-9 mine continued to climb this quarter with zinc production increasing 7% QoQ to 25.0mlbs, silver production increasing 10% to 421koz, gold production increasing 2% to 4.3koz, while copper production declined modestly to 2.1mlbs. There was a modest decline in copper production was largely attributable to mine sequencing resulting in lower head grades during the quarter.

The mill operated above design capacity at an average of 1,691tpd during the quarter and has achieved in excess of 1,900tpd in March and April. Metallurgy continues to be a key focus for the operation and metal recoveries have increased to 82% for zinc and 59% for copper in the quarter, verses 80% and 56%,

### Stock Rating:

**Buy**

12- target (C\$)	\$1.00
Potential ROR	76%

### 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\$)	\$264.8
Mkt cap, FD (C\$)	\$276.9

### Key Metrics

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

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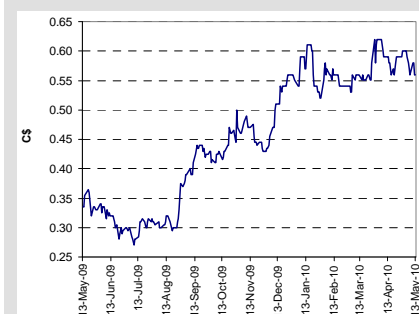
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### 1-Year Stock Chart



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

respectively in Q4/09. The plant metallurgical group continues to analyse its performance and better understands of the relationship of lead and iron to both the copper and zinc metallurgical performance and can better adjust operating parameters for changing feed conditions. Zinc concentrate grades averaged 48.4% during the quarter and copper concentrate grades averaged 14.0%. Once the G-9 mill is able to achieve its targeted metal recovery rates, management will focus on increasing the concentrate grades, particularly for copper.

Mill throughput has virtually achieved its expansion throughput target of 2,000tpd as at the end of March; a full quarter ahead of schedule. The mill is now ahead of the mine, and the current mine plan is being re-evaluated for options to catch up. Management will hold the mill throughput steady at 1,900tpd – 2,000tpd until the mine production level can be increased to match mill capacity and the capital that had been allocated for the plant expansion in 2010 will now be used for additional underground development. Potential expansion of the mill beyond 2,000tpd will be examined once the additional mine development has been completed; no timeline for this study has been provided.

Higher production and lower treatment charges resulted in cash costs declining in the quarter from \$0.44/lb in Q4/09 to \$0.38/lb in Q1/10. Smelter treatment charges declined due to price participation terms reverting to normal contract terms in the company's off-take agreement with Trafigura in Q1. As production levels increase, management expects unit costs to decline further. In the month of March, total cash costs were \$0.31/lb of zinc.

Exploration work is continuing with two surface drills focusing extensions to mineralization in the North zone and Abajo zone, and an underground drill testing high-grade mineralization within close proximity to the existing mining operations. Subsequent to the quarter end, management announced the discovery of three stratigraphically distinct high-grade gold zones below the main zinc orebodies and in close proximity to existing mining operations. Further drilling is underway to delineate these areas while a comprehensive metallurgical program has been initiated to identify the optimum method to recover the gold and silver. Further study is required before these high-grade zones can be brought into the current mine plan. Additionally, work is continuing on an engineering study for the treatment of the El Largo, Naranjo and El Ray deposits. Management expects to be able to provide an update on the preliminary economic study of these deposits before the end of Q2/10.

### **Maintain Buy Recommendation**

We have made only minor adjustments to operational estimates and have updated our financial model to reflect Farallon's current balance sheet. Our NAV is essentially unchanged at \$0.99 and we maintain our \$1.00 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
Basic			4.5
Warrants			17.2
Options			0.0
Convertible Debs			494.4
Fully Diluted			

Source : Company, Paradigm Capital

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