

Farallon Mining Ltd.

FAN-TSX

Drill Results an Encouraging Sign for Resource Growth

Event

Prior to market open on December 16, 2009 Farallon Mining released drill results from its G-9 deposit in Mexico.

Action

We recommend buying Farallon Mining's shares.

Analysis

- **Drilling suggests continuity of the G-9 deposit** – The exploration drilling intersected high-grade zinc mineralization to the northwest and the southeast of the North Zone, and to the west of the Abajo Zone. Importantly, both of these areas are close to the company's current underground workings. One of the highlights of the drilling was hole UG-09-120 (northwest of the North Zone), which intersected 5 metres of 36% Zn, 2.9% Cu, 1.6 g/t Au, 83 g/t Ag, and 1.1% Pb.
- **Supports our long-term investment thesis for organic growth opportunity** – Combined with previous exploration success we believe that these drill results bode well for the potential to grow the resource at G-9. The G-9 mine has a relatively short mine life (we have modeled production through 2015E), and in our view, resource growth is the key to extending the mine life. We estimate that at a zinc price of US\$1.10/lb adding one additional year to the G-9 mine would increase our NAV by 8%, or C\$0.10 per share.
- **Potential near-term catalysts for the stock:** 1) the next batch of drill results – expected in late January 2010 to February 2010, 2) the preliminary economic assessment (PEA) for the satellite deposits at G-9 – expected in 1Q09, 3) the continued progression in the ramp-up of production at the mine to a design rate of 1,500 tonnes/day, and 4) the expansion of the mill by roughly 33%, to an expected 2,000 tonnes/day in 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 0.65x. Our target price of C\$0.75 is based on a 0.70x multiple applied to our NAV of C\$1.07 per share (in-line with risk and liquidity-adjusted historic producer multiples).

RATING & TARGET

RATING	OUTPERFORM 2 =
Target Price (6-12 mths) (C\$)	0.75 =
Closing Price (C\$)	0.54
Total Return to Target	39%

MARKET DATA

Market Capitalization (US\$mIn)	240
Current Net Debt (US\$mIn) (3Q09A)	18
Enterprise Value (US\$mIn) (2009E)	259
Basic Shares Outstanding (mln)	472.4
Avg Daily Dollar Volume (3mo, mln)	n/a
52 Week Range (C\$)	\$0.12 - \$0.54

KEY FINANCIAL METRICS

FY-Dec 31	2008A	2009E	2010E
EPS (US\$)	(0.22)	(0.01)	0.19
P/E (x)	nmf	nmf	2.6
EPS - 1Q (US\$)	nmf	(0.02)	0.05
EPS - 2Q (US\$)	nmf	(0.02)	0.05
EPS - 3Q (US\$)	nmf	(0.00)	0.05
EPS - 4Q (US\$)	nmf	0.02	0.05
NAVPS (C\$)		1.07	
P/NAV(x)		0.50	
Revenue (US\$mIn)	nmf	83	171
EBITDA (US\$mIn)	nmf	16	122

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

Highlights of the Drill Results

Highlights of the drill results include (listed by area and drill hole number):

Northwest of the North Zone:

- UG-09-103 – 5.6 metres of 26.2% zinc, 1.6% copper, 2.0 g/t gold, 97 g/t silver, and 0.9% lead.
- UG-09-104 – 6.8 metres of 25.0% zinc, 3.2% copper, 2.2 g/t gold, 305 g/t silver, and 3.3% lead.
- UG-09-105 – 4.3 metres of 36.4% zinc, 3.8% copper, 1.5 g/t gold, 113 g/t silver, and 0.7% lead.
- UG-09-108 – 4.9 metres of 20.1% zinc, 1.9% copper, 1.3 g/t gold, 101 g/t silver, and 0.8% lead.
- UG-09-118 – 5.6 metres of 33.1% zinc, 3.6% copper, 1.3 g/t gold, 129 g/t silver, and 0.8% lead.
- UG-09-120 – 10.2 metres of 27.7% zinc, 2.4% copper, 1.3 g/t gold, 73 g/t silver, and 1.0% lead (including 5.0 metres of 36.1% zinc, 2.9% copper, 1.6 g/t gold, 83 g/t silver, and 1.1% lead).

Southeast of the North Zone:

- UG-09-134 – 10.7 metres of 12.5% zinc, 1.5% copper, 2.0 g/t gold, 154 g/t silver, and 1.5% lead (including 2.3 metres of 16.0% zinc, 1.7% copper, 2.3 g/t gold, 169 g/t silver, and 1.2% lead).

Western extremity of the Abajo Zone:

- UG-09-056 – 9.6 metres of 15.6% zinc, 1.4% copper, 2.1 g/t gold, 140 g/t silver, and 1.2% lead.
- UG-09-061 – 6.3 metres of 21.6% zinc, 2.0% copper, 2.3 g/t gold, 266 g/t silver, and 1.1% lead.

Upper North Zone:

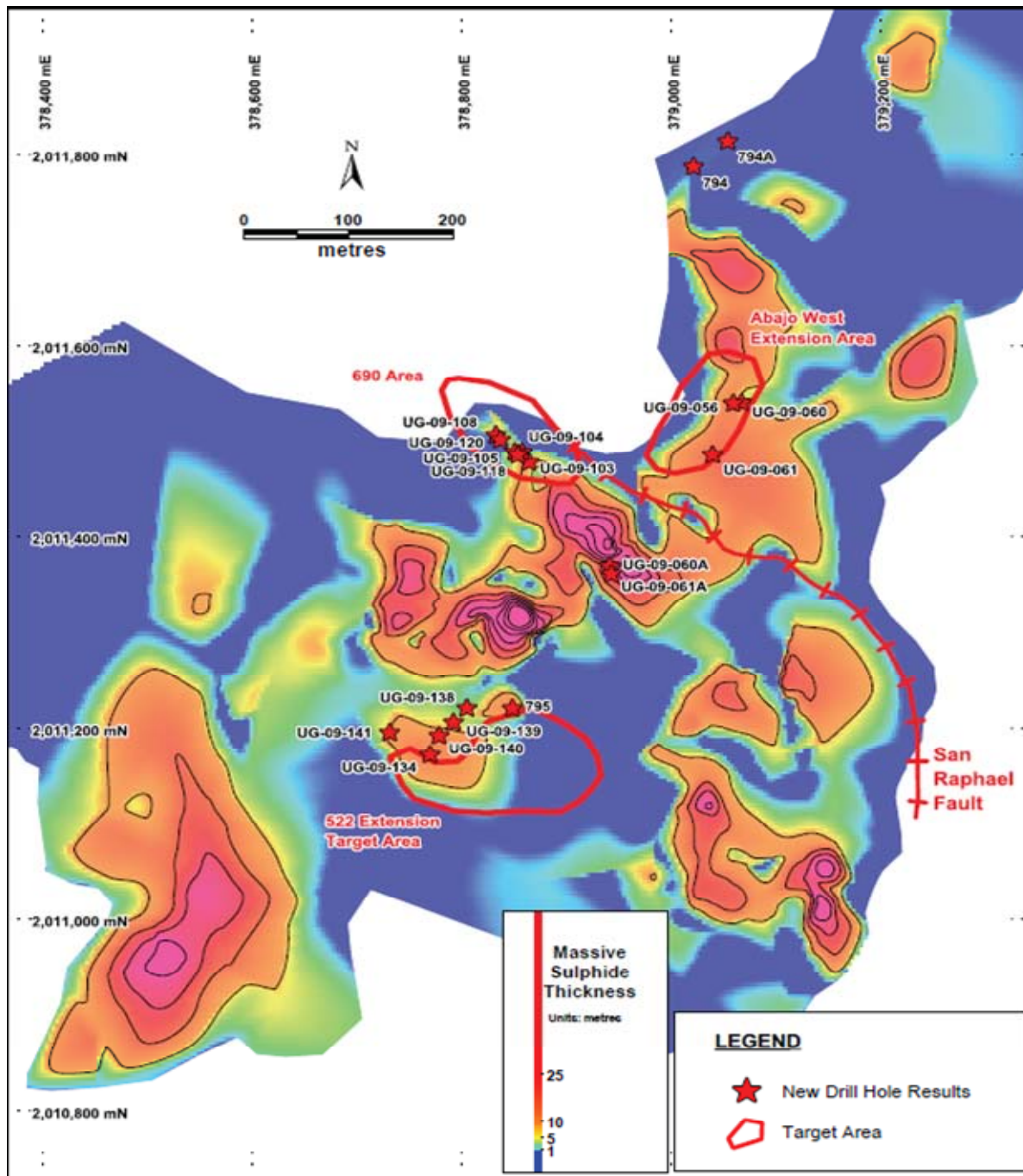
- UG-09-060A – 13.4 metres of 4.6% zinc, 0.35% copper, 19.7 g/t gold, 1700 g/t silver, and 4.0% lead.
- UG-09-061A – 8.4 metres of 4.2% zinc, 0.35% copper, 19.5 g/t gold, 1004 g/t silver, and 4.7% lead.

For comparison we note that at a 5% zinc cut-off the G-9 deposit has a Measured, Indicated and Inferred resource of 3.8 million tonnes grading 10.1% zinc, 1.3% copper, 2.9 g/t gold, 196 g/t silver, and 1.3% lead.

Farallon also tested the stratigraphic separation between the El Largo deposit and the Abajo Zone of the G-9 deposit. Hole DDH 09-794 was drilled through both the El Largo and Abajo horizons and intersected 15 metres (not true width) of 3.2% copper (minimal zinc, gold, silver, and lead grades). The

company intends to further investigate the copper potential at El Largo. Exhibit 1 shows the map of the drill hole locations around the G-9 deposit.

Exhibit 1: Drill Hole Locations



Source: Company reports

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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