

Farallon Resources Ltd. (FAN-T, \$0.185)

Recommendation: Buy

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All values in C\$ unless otherwise noted.

Current Price	\$0.185
Target Price (12-Month)	\$0.65
Target Return	251%

Changes

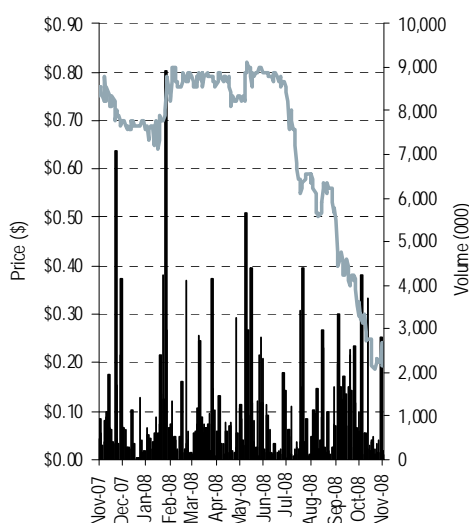
	Old	New
Recommendation	Buy	Unchanged
Target	\$0.70	\$0.65
CFPS 2009E	US\$0.08	US\$0.09
CFPS 2010E	US\$0.16	US\$0.13

Company Profile

Farallon Resources is a Canadian-listed mineral development company that owns 100% of the Campo Morado zinc-rich volcanogenic massive sulphide (VMS) project in Mexico.

www.farallonresources.com

Price Chart



Source: Thomson ONE

Revised Mine Plan Aims to Maximize Early Cash Flow; Zn Grades Lower-than-Expected

- Revised G-9 mine plan targets 800kt @ 12% zinc over 20 months.**
Compares with our previous estimate of 880kt grading 12.8% zinc. Lower grades likely through FY12 as grades in the Southeast zone fall short.
- New mining method to lessen development costs, rates unaltered.**
New mine plan employs open-stopping methods to expedite development of high grade zones; no change to mining rates, leaving op costs intact.
- Lower grades at static costs undercuts FY10 CFPS and NAV est.**
Combined effect of lower grades at existing costs lowers our FY10 CFPS to US\$0.13 from US\$0.16 and NAVPS est. to \$0.93 from \$0.96.
- Lowering target to \$0.65; maintain Buy rating.**
Target derived using an equal weighting to 0.8x our NAV estimate of \$0.93/sh and 4.0x our FY10 CFPS estimate of US\$0.13.

Financial Summary

Shares Out (mm)	370.4	52-Week Range	\$0.15 - \$0.84
Market Cap (mm)	\$68.5	Avg Weekly Volume	4,743,376
Shares, FD (mm)	388.3	Fiscal Year End	Jun-30
Working Capital (mm)	\$64.8	NAV/Share, FD	\$0.93
Enterprise Value (mm)	\$77.7	P/NAV	0.2 x

Key Properties:

Campo Morado, Mexico (100%)	Annual Zn production - payable (000 lbs)	74,405
Polymetallic zinc-rich VMS deposit	Annual Au production - payable (oz)	9,325
Capex \$140mm	Total Cash Costs (US\$/lb, after credits) (1)	0.22
Estimated start date	H2/08	

Key Management:

Dick Whittington	President and CEO
Greg McCum	Chief Financial Officer
Ronald Thiessen	Chairman and Director

Key Shareholders:

Management (5%)

(1) Life of mine average - includes amortization of pre-sold silver.

(2) Includes the proceeds from a recently completed \$25mm promissory note offering and \$7.75mm convertible offering.

Source: WWCM Estimates, Company Reports

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Investment Summary and Outlook

Building a mine at G-9. Farallon's principal asset is the 100%-owned Campo Morado zinc-rich polymetallic project in Guerrero State, Mexico. The company's development effort is focussed on the high-grade G-9 deposit. Mine commissioning is nearly complete and full steady-state production of 1,500 tonnes per day (tpd) is expected in January 2009.

Low cash cost potential of G-9 should allow Farallon to weather the depressed metal price environment. The combined effect of G-9's high grades and substantial by-product credits from copper, gold, silver, and lead, should result in steady-state total cash costs that fall well within the lowest quartile among zinc producers, thereby enabling the company to weather the current weak metal price environment. At our metal price assumptions, we estimate average total cash costs for the next three years of US\$0.05/lb of zinc. Even at current metal prices, our analysis suggests that for the first three years Farallon could report total cash costs of approximately US\$0.20/lb of zinc, after by-product credits – still well within the lowest quartile for zinc producers.

We use a discounted cash flow (DCF) analysis and P/CF multiples to arrive at a 12-month target price of \$0.65 (\$0.70 previously). Our target price is based on a blended multiple with an equal weighting assigned to a multiple of 0.8x our NAV estimate of \$0.93/share (\$0.96/share previously) and a 4.0x multiple of our FY10 CFPS estimate of US\$0.13 (US\$0.16 previously). We reiterate a Buy recommendation, but are lowering our target price to \$0.65.

New Mine Plan for G-9 Shifts High-Grade Forward

Precious metals provide a partial buffer. On November 10, 2008, Farallon Resources tabled a revised 20-month mine plan for the 100%-owned G-9 mine on the Campo Morado property in Mexico. The plan envisages the mining of 800,000 tonnes grading 12% zinc, 1.6% copper, 1.3% lead, 230 g/t silver and 3.2 g/t gold between November 1, 2008 and June 30, 2010. The new estimate compares with previous company guidance (Aug. 21/08) of 700,000 tonnes grading 13% zinc, 1.5% copper, 1.2% lead, 150 g/t silver and 2.2 g/t gold over 17 months. We had previously modeled the mining of 880,000 tonnes grading 12.8% zinc, 1.8% copper, 1.2% lead, 2.18 g/t gold and 184 g/t silver during FY09 and FY10.

Targeting high-grade earlier to maximize cash flow. The revised mine plan essentially moves higher-grade material forward in the schedule in an attempt to maximize cash flow in FY09 at the expense of the same in FY10. We believe the plan reflects the need to support working capital (\$29mm at June 30/08) and to repay the \$25mm six-month promissory notes bearing interest at 15% per annum.

Changes to our model. We now model the mining of 330,000 tonnes (355,000 tonnes previously) grading 12.3% zinc, 1.8% copper, 0.9% lead, 2.5 g/t gold, and 185 g/t silver between November 2008 and June 2009 (FY/09) – higher nearly across the board than our previous estimates. The opposite is generally true

(aside from a material increase in precious metal credits) during FY10, which we now estimate will see the mining of 525,000 tonnes grading approximately 11.5% zinc, 1.5% copper, 1.4% lead, 3.5 g/t gold, and 250 g/t silver – essentially the same tonnage previously modeled but at the newly indicated grades. The net result is a slight increase in our FY09 CFPS and decrease in FY10 CFPS (Exhibit 1).

Exhibit 1: Modest Revisions to FY09 and FY10 EPS and CFPS Estimates

	FY09E	FY10E
EPS, f.d.		
-new	(US\$0.02)	US\$0.05
-old	(US\$0.03)	US\$0.06
CFPS, f.d.		
-new	US\$0.09	US\$0.13
-old	US\$0.08	US\$0.16
NAV, f.d.		
-new	\$0.93	
-old	\$0.96	

Source: WWCM Estimates

Lower mining costs on the horizon? In an attempt to offset the lower grades, Farallon's plan includes the expanded use of lower-cost open-stopping mining methods, which reduce the amount of underground development required to reach the targeted zones. The plan also calls for high-grade areas in the Southeast zone to be accessed earlier than previously planned. Despite the planned move to cheaper bulk-mining, we prefer to remain more conservative and maintain our existing mining cost estimates (US\$25/tonne mined), as the revised mine plan does not represent a change in the throughput rate, but rather a slight change in the mining technique. Additionally, the revised mine plan does not include associated cost data. We do, however, highlight the potential for some savings on sustaining capex owing to the potential for less underground development.

Fluid numbers reflect evolution of the mine plan and realities of commissioning. We highlighted as far back as our initiating coverage piece (June 26/08) the higher level of potential risk introduced by Farallon's decision to forgo a feasibility study at G-9 in return for an accelerated development timeline. We contend that the recent revision to the mine plan (grades and tonnages) highlight this risk, and justify our adherence to more conservative assumptions than we would otherwise apply.

Low cash cost potential of G-9 should allow Farallon to weather the depressed metal price environment. Given the current low metal price environment, we felt it prudent to stress test our FY10 CFPS estimates against zinc and copper prices. Our analysis suggests that at current metal prices, FAN's cash flow should amount to US\$0.08/share, compared with our estimate of US\$0.13.

Exhibit 2: FY10 Cash Flow Sensitivity to Changes in Copper & Zinc Prices

Cu Price Assumption - US\$/lb	US\$/share	Zn Price Assumption - US\$/lb							
		0.40	0.50	0.60	0.70	0.80	0.90	1.00	1.10
1.40		0.05	0.08	0.10	0.11	0.13	0.15	0.16	0.18
1.60		0.06	0.08	0.10	0.12	0.13	0.15	0.17	0.19
1.80		0.06	0.09	0.11	0.12	0.14	0.16	0.17	0.19
2.00		0.07	0.09	0.11	0.13	0.14	0.16	0.18	0.20
2.20		0.08	0.10	0.12	0.13	0.15	0.17	0.18	0.20
2.40		0.09	0.10	0.12	0.14	0.15	0.17	0.19	0.20
2.60		0.09	0.11	0.12	0.14	0.16	0.18	0.19	0.21
2.80		0.10	0.11	0.13	0.15	0.16	0.18	0.20	0.21
3.00		0.10	0.12	0.13	0.15	0.17	0.19	0.20	0.22

Source: WWCM Estimates

Lowering Target to \$0.65; Maintain Buy Rating

We reiterate a Buy rating, but lower our target price to \$0.65. In response to downward revisions to both our NAV and FY10 cash flow estimates, we are lowering our target price to \$0.65, while maintaining a Buy rating. Our target price is based on a blended multiple with an equal weighting assigned to a multiple of 0.8x our NAV estimate of \$0.93/share (\$0.96/share previously) and a 4.0x multiple of our FY10 CFPS estimate of US\$0.13 (US\$0.16/share previously).

Appendix: Summary Cash Flow Statement

	Units	FY08A	FY09E	FY10E	FY11E
Zn Price (calendar)	US\$/lb	0.86	0.65	0.80	1.00
Zn Price (fiscal)	US\$/lb	1.17	0.76	0.73	0.90
US\$/C\$ (fiscal)	US\$/C\$	0.94	0.92	0.90	0.90
Payable Zn sales	mm lbs	na	67.5	106.5	106.5
Total cash costs (1)	US\$/lb	na	0.02	0.03	0.05
Net Income	US\$, mm	(80.6)	(7.1)	18.6	57.9
Depreciation	US\$, mm	0.0	47.7	45.7	6.7
Amort. of Ag sales	US\$, mm	0.0	(6.0)	(12.9)	(8.8)
Deferred income tax	US\$, mm	0.0	0.0	0.0	0.0
Other	US\$, mm	1.0	1.0	0.0	0.0
Operating cash flow	US\$, mm	(79.6)	35.6	51.3	55.8
EPS, f.d.	US\$/sh	(0.26)	(0.02)	0.05	0.15
CFPS, f.d.	US\$/sh	(0.25)	0.09	0.13	0.15
P/E		nm	3.3x	1.1x	0.9x
Basic shares out		302.5	370.4	370.4	370.4
F.d. shares out		313.0	380.9	380.9	380.9

Source: Company Reports, WWCM Estimates

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Farallon Resources	FAN-T	11

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