

Farallon Mining

(FAN-T, \$0.29)

Start-up Problems Should Not Cloud The Potential

Financial Summary (C\$)

(end-Dec)	Revenue (m)	CFPS	P/CF (x)	EPS	P/E (x)
2007	0.1	-0.02	nm	-0.03	nm
2008	35.9	-0.01	nm	-0.03	nm
2009e	119.2	0.08	3.6	0.06	4.9
2010e	208.4	0.22	1.3	0.21	1.4

All figures in C\$ unless otherwise noted

- ▶ Farallon continues to make excellent progress with the ramp up to design at G9, albeit it with a few set backs with recoveries and concentrate grade issues in the mill.
- ▶ The mine continues to perform up to expectations and is currently at the design capacity of 1,500 tpd. Additional working faces and the development of the South East zone should provide the mill with a more consistent feed which should go some way to improving recoveries and concentrate grades.
- ▶ Our revised NAV is \$0.82, which is down from \$0.86 based on a more conservative set of operating assumptions for 2009. Our target is now \$0.80 based on our revised 1X multiple to the NAV. We maintain our Buy recommendation.

G9 Commissioning – No Fatal Flaws it Just Needs Time

In early June we had an opportunity to conduct a site visit to the G9 mine and mill. We came away with a very positive outlook despite lingering recovery problems in the mill; a situation that requires time and focus to rectify. The mine reached design of 1,500 tpd in April with production from three separate zones within the G9 ore deposit. In late June ore production is expected to start in the South East zone, Figure 1, which will be the source of approximately 50% of the production for the next three years. This zone should deliver a more predictable feed to the mill and, due to the nature of the ore lens, should result in less dilution. To date mining has validated the tonnage and grade for those areas defined in the drilling which is significant as the G9 does not have a 43-101 ore reserve/resource. More importantly definition drilling continues to expand the mineralized zones current in the mine plan as well as new potential areas such as the Abajo zone and the West Extension. As mining and additional drilling progresses, it is expected that a better understanding of the geology should result in additional discoveries of mineralization. The camp has had a prolific exploration record of discovery as it is a stacked volcanic plie with at least three mineralized horizons of which two have significant zones of mineralization. We are of the view that with sufficient exploration the resources will be increased to allow potential expansion to at least 2,200 tpd.

Stock Rating:

Buy

12- target (C\$) **↑ \$0.80**
 Potential ROR 175%

Company Profile

Sector	Base Metals
Ticker	FAN-T
Shares O/S, basic (m)	408.2
Shares O/S, diluted (m)	411.2
Mkt cap, basic (C\$)	\$118.4
Mkt cap, FD (C\$)	\$119.2

Key Metrics

NAV/sh (C\$)	\$0.82
Cash (C\$)	\$35.0m
Debt (C\$)	\$36.0m

Research Team

David Davidson
 Analyst 416.360.3462
 Ddavidson@paradigmcap.com

Michael Bandrowski
 Associate 416.360.1397
 Mbandrowski@paradigmcap.com

Sales

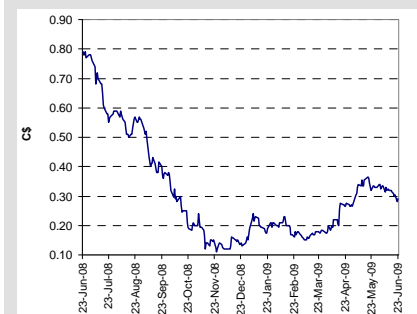
Toronto 416.361.1064
 Calgary 877.513.1025

Paradigm Capital research is available on First Call, Reuters or at www.paradigmcap.com

Refer to last page for official disclaimer

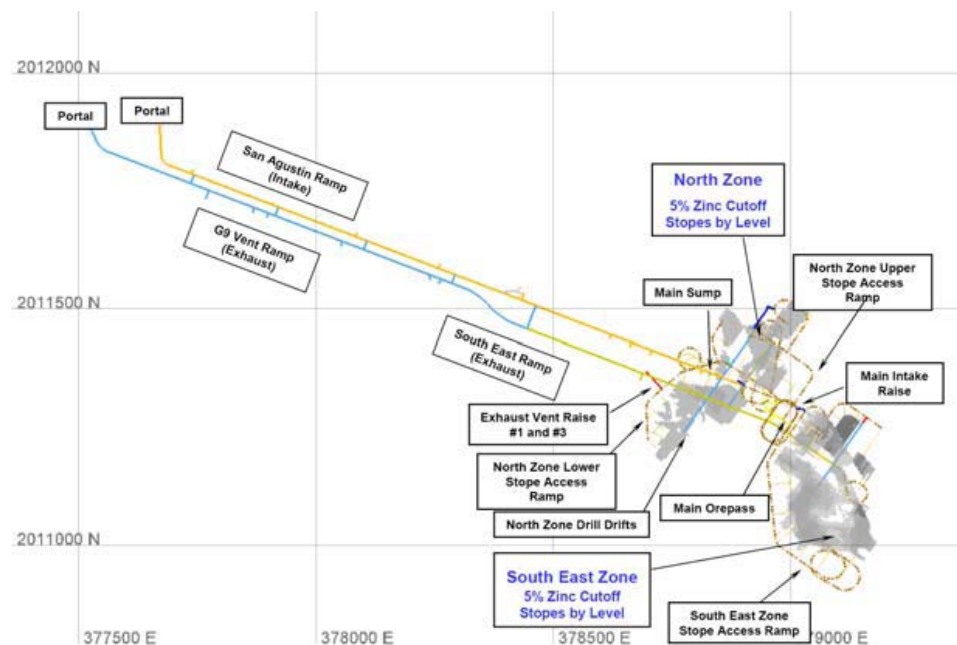
Issued by Paradigm Capital Inc.

1-Year Stock Chart



06/23/09 Target raised (\$0.80)
 03/24/09 Target lowered (\$0.65)
 11/21/08 Target lowered (\$0.75)
 10/08/09 Target lowered (\$1.20)
 03/14/07 Initiating target price (\$1.10)

Source: Bloomberg

Figure 1: Underground Mine Layout


Source : Company, Paradigm Capital

The mill is presently of concern as it has yet to reach design in many areas. It should be pointed out that commissioning of fine grained, polymetallic base metal mines generally have had their share of mill start up difficulties. The zinc circuit at G9 is closest to design with recoveries of zinc approaching 80% and concentrate grade at an acceptable 52% zinc. Lead recoveries and concentrate grade remain below design by approximately 25%. Because of the high precious metal content of the lead concentrates they are well received by the offtake partner, Tafiura. The copper continues to be the main concern as it represents the largest percentage of the by product value. Copper recovery has varied in the last two months from approximately 40% in April to 59% in May which is a significant improvement. However concentrate grade dropped from approximately 20% to just under 15%. Again, despite the concentrate grade being low it is a saleable product and the increased copper units largely offset additional freight and handling costs associated with the higher volumes of concentrate. While we don't profess to be experts in the dark science of metallurgy it seems only logical that if the mill had a more consistent head grade, accomplished by blending of the various ore zones, there should be some improvements in recoveries. The addition of a reclaim water treatment plant, expected in late June early July should also be a major step towards improving operating performance. The mill facility, once stabilized, should have the ability to handle at least 2,000 tpd without major capital. Further expansion is possible if the resource base is further expanded, which we believe is just a matter of time and exploration dollars. We have lowered our expectations for some parameters for 2009 based on the first five months of operation. Longer term only minor changes have been made. The changes are illustrated in Table 2. Despite these more conservative stance, Farallon should still be well within the lowest quartile of cash costs to produce a pound of zinc globally.

Figure 2: Revised Parameters in Our Model for Farallon

		2009	OLD 2010	2011	2009	NEW 2010	2011
Throughput	t / day	1,450	1,700	2,000	1,450	1,650	1,850
Total Cost	\$ / t	\$152	\$144	\$140	\$150	\$147	\$146
Net Cash Cost	\$ / lb	\$0.19	\$0.12	\$0.16	\$0.25	\$0.14	\$0.20
Recoveries							
Zn	%	85	85	85	80	85	85
Cu	%	70	70	70	65	70	70
Pb	%	40	40	40	40	40	40
Au	%	42	42	42	42	42	42
Ag	%	60	60	60	50	60	60
Conc. Grade							
Zn	%	52.0	52.0	52.0	52	52	52
Cu	%	21.0	21.0	21.0	18	20	20
Pb	%	34.0	34.0	34.0	28	30	30
Production							
Zn	m lbs	108	122	138	92	128	144
Cu	m lbs	11	13	15	9	13	14
Pb	m lbs	6	6	6	5	6	6
Au	k oz	21	24	28	18	24	27
Ag	k oz	1,968	2,308	2,692	1,439	2,358	2,621

Source : Company, Paradigm Capital

Mine Life – Likely 11 Years With Potential To Double

Currently, we expect the G9 mine to have approximately 11 years of mine life at an average throughput rate of 1,900 tonnes per day. We are modelling a resource of 7.33m tonnes grading 9.1% zinc, 1.2% copper, 1.1% lead, 0.084 oz/t gold and 5.76 oz/t silver. The last published resource by Farallon consisted of 5.98m tonnes grading 7.63% zinc, 1.14% copper, 1.14% lead, 0.089 oz/t gold and 5.73 oz/t silver. However, we would note that the company has experienced significant exploration success since it last reported a resource estimate. Additionally, we believe that there remains significant upside potential to increase the tonnage at G9 above and beyond our estimates. In such a case, the company would likely increase the plant throughput to at least 2,000 tonnes per day which we currently have modelled as beginning in 2011. An increase to 2,500 tpd within the same timeframe could be accomplished with only modest capital spending and increase our NAV by up to 20%.

Maintain Buy, Target Increased

We believe the next quarter will be the most critical for Farallon since its inception. Within the next three months, the company is expected to solve many of the mill issues that have surface since commissioning in April, 2009. As we mentioned earlier we do not see any fatal flaws in either the mine or the mill and while it may

take some additional time to get the mill performance to acceptable levels, it will be well worth the wait. We also hasten to remind investors that the G9 deposit was only discovered June 6th 2005. This means that by the end of Q2, Farallon will have raised over \$150m in funding (including a silver off-take agreement with Silver Wheaton), constructed and commissioned a mine and all within four years of the discovery drill hole and without ever conducting a bankable feasibility study. That is an extremely impressive feat and demonstrates the superb quality of the people driving the company. Once Farallon has turned the corner and fully commissioned G9, we expect the management will look to expand the operation to optimise the high quality ore deposit and the exploration potential.

We have adjusted our model to reflect the recent debt financing and slightly reduced output for 2009. Our NAV has been reduced from \$0.86 to \$0.82 due to the above changes, Figure 2. We are increasing our NAV multiple to 1X NAV versus the previous 0.75X as we feel the recovery in the commodity complex is well underway, see the Paradigm report published on June 24, 2009. This gives us a revised target of \$0.80 per share.

Figure 1: Revised Net Asset Value for Farallon

	<u>US\$ m</u>	<u>C\$ m</u>	<u>C\$/sh</u>	
OPERATING ASSETS				
G9 Campo Morado (8%DCR)	\$287.5	\$328.6	\$0.80	
Total	\$287.5	\$328.6	\$0.80	
OTHER ASSETS				
Working Capital (of which cash is \$35m)	\$26.3	\$30.0	\$0.07	
Other Properties	\$4.4	\$5.0	\$0.01	
Cash from Exercise of Options and warrants	\$1.6	\$12.7	\$0.03	
Other Investments (Marketable securities)	\$0.9	\$1.0	\$0.00	
Total	\$33.1	\$48.7	\$0.12	
TOTAL ASSETS	\$320.6	\$377.2	\$0.92	
LIABILITIES				
Term Loan	\$30.0	\$36.0	\$0.09	
Convertible Debentures	\$0.0	\$0.0	\$0.00	
Environmental/Other	\$1.2	\$1.3	\$0.00	
Long term leases	\$1.4	\$1.6	\$0.00	
Total	\$32.6	\$38.9	\$0.09	
TOTAL LIABILITIES	\$32.6	\$38.9	\$0.09	
NET ASSET VALUE	\$288.1	\$338.3	\$0.82	
Exchange Rate				
US\$ /C\$	1.14			
US\$	2009	2010	Longterm	Shares Outstanding
Zn	\$0.75	\$1.05	\$0.80	Basic 408.20
Cu	\$2.25	\$3.00	\$1.75	Warrants 3.00
Pb	\$0.75	\$0.95	\$0.70	Options 0.00
Au	\$925	\$925	\$925	Convertible Debs 0.00
Ag	\$5.30	\$5.30	\$5.30	Fully Diluted 411.20

Source : Company, Paradigm Capital

Disclaimer Section

1. David Davidson does not have an ownership position in Farallon Resources (FAN-T).
2. Michael Bandrowski does not have an ownership position in Farallon Resources (FAN-T).
3. Paradigm Capital Inc. has assumed an underwriting liability for, and/or provided financial advice for consideration to Farallon Resources (FAN-T) during the past 12 months.
4. Paradigm's disclosure policies and research distribution procedures can be found on our website at www.paradigmcap.com.

Research Rating System

Paradigm Capital uses the following rating recommendations in its research:

Speculative Buy – Expected returns of 10% or more over the next 6-12 months on high-risk development or "pre-revenue" companies, such as junior mining and early stage biotech companies. (17% of Paradigm's coverage list consists of Speculative Buy recommendations).

Buy – Expected returns of 10% or more over the next 6-12 months. (64% of Paradigm's coverage list consists of Buy recommendations).

Hold – Expected returns of +/-10% over the next 6-12 months. (15% of Paradigm's coverage list consists of Hold recommendations).

Sell – Expected returns of -10% or more over the next 6-12 months. (4% of Paradigm's coverage list consists of Sell recommendations).

About Paradigm Capital Inc.

Paradigm Capital is a research-driven, independent, institutional equity investment dealer focused on sectors and companies that have attractive long-term secular growth prospects. Paradigm Capital's research is available on our website at www.paradigmcap.com. Please speak to your Sales or Trading Representative if you require access to the website

The analyst (and associate) certify that the view expressed in this report accurately reflect their personal views about the subject securities or issuers; No part of their compensation was, is, or will be directly or indirectly, related to specific recommendations expressed in this research report.

Analysts are compensated through a combined base salary and bonus payout system. The bonus payout is determined by revenues generated directly or indirectly from various departments including Investment Banking, based on a system that includes the following criteria: reports generated, timeliness, performance of recommendations, knowledge of industry, quality of research and investment guidance and client feedback. Analysts are not directly compensated for specific Investment Banking transactions.

The opinions, estimates and projections contained herein are those of Paradigm Capital Inc. ("PCI") as of the date hereof and are subject to change without notice. PCI makes every effort to ensure that the contents herein have been compiled or derived from sources believed reliable and contain information and opinions, which are accurate and complete. However, PCI makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any loss arising from any use of, or reliance on, this research report or its contents. Information may be available to PCI, which is not reflected herein. This research report is not to be construed as an offer to sell, or solicitation for or an offer to buy, any securities. PCI, its affiliates and/or their respective officers, directors or employees may from time to time acquire, hold or sell securities mentioned herein as principal or agent. PCI may act as financial advisor and/or underwrites for certain of the corporations mentioned herein and may receive remuneration for same. Paradigm Capital Inc. is a member of The Toronto Stock Exchange, The TSX Venture Exchange and The Investment Industry Regulatory Organization of Canada (IIROC).

Any products or services mentioned on this website are made available only in accordance with local law (including applicable securities laws) and only where they may be lawfully offered for sale. Paradigm Capital Inc. will not open accounts except in jurisdictions in which it is registered.

To U.S. Residents: This report was prepared by Paradigm Capital Inc. which is not subject to the U.S. rules with regard to the preparation of research reports and the independence of analysts. Paradigm Capital U.S. Inc, affiliate of PCI, accepts responsibility for the contents herein, subject to the terms as set out above. Any U.S. person wishing to effect transactions in any security discussed herein should do so through Paradigm Capital U.S. Inc.