

**Adam Low, CFA**  
adam.low@raymondjames.ca  
416.777.4943

# Farallon Mining Ltd.

FAN-TSX

## 3Q09 Falls Slightly Short; 4Q09 Off to a Good Start

### Event

Farallon reported 3Q09 results and provided an operational update.

### Action

We recommend buying Farallon Mining's shares.

### Analysis

- **3Q09 earnings essentially in-line** – EPS was US\$0.00, which compares to our estimate of US\$0.01. Revenue of US\$30 million was higher than our expectation of US\$20 million; however, this included the sale of inventory from an earlier stage of production that had a higher associated cost, thus reducing the gross margin. Management stated that all of the higher cost inventory has now been sold.
- **3Q09 production up sequentially, but below expectations** – Overall, in 3Q09 production increased sequentially, but fell short of our estimates. Ramp-up challenges on metallurgical performance and mill availability continued during the quarter. In 3Q09 Farallon produced 10,047 tonnes of zinc, below our forecast of 12,432 tonnes. However, given that the G-9 mine is still working its way to full production some variability and start-up issues are not uncommon.
- **4Q09 off to a good start** – The G-9 ramp-up improved heading into 4Q09. During the month of October the mill operated at 1,600 tonnes/day (7% above design capacity), and recovery rates for zinc, copper and silver reached their highest monthly rates.
- **Forecast changes** – Our revised EPS estimates for 2009E, 2010E, and 2011E are -US\$0.01 (prev. US\$0.00), US\$0.17 (prev. US\$0.19), and US\$0.12 (prev. US\$0.14), respectively. We have reduced our NAV estimate to C\$0.77 (prev. C\$0.86), and increased our P/NAV multiple to 0.70x (prev. 0.60x) reflecting peer group trading multiple expansion.

### Valuation

Farallon's shares trade at a P/NAV of 0.62x. This compares to the weighted average of base metal producers of 0.89x. Our target price of C\$0.55 is based on a 0.70x multiple applied to our NAV of C\$0.77 per share (in-line with risk and liquidity-adjusted historic producer multiples).

### RATING & TARGET

RATING	OUTPERFORM 2 =
Target Price (6-12 mths) (C\$)	0.55 =
Closing Price (C\$)	0.48
Total Return to Target	16%

### MARKET DATA

Market Capitalization (US\$m)	175
Current Net Debt (US\$m) (3Q09A)	18
Enterprise Value (US\$m) (2009E)	193
Basic Shares Outstanding (mln)	472.4
Avg Daily Dollar Volume (3mo, mln)	n/a
52 Week Range (C\$)	\$0.11 - \$0.54

### KEY FINANCIAL METRICS

FY-Dec 31	2008A	2009E	2010E
EPS (US\$)	(0.22)	(0.01)	0.17
P/E (x)	nmf	nmf	2.2
EPS - 1Q (US\$)	nmf	-0.02	0.04
EPS - 2Q (US\$)	nmf	-0.02	0.04
EPS - 3Q (US\$)	nmf	-0.00	0.04
EPS - 4Q (US\$)	nmf	0.02	0.04
NAVPS (C\$)		0.77	
P/NAV(x)		0.62	
Revenue (US\$m)	nmf	82	156
EBITDA (US\$m)	nmf	15	107

### 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

### **3Q09 Production – Modestly Improved Sequentially, but Below Expectations**

Overall, 3Q09 production increased sequentially, but fell short of our estimates. Ramp-up challenges on metallurgical performance and mill availability continued during the quarter. In 3Q09 Farallon produced 10,047 tonnes of zinc, below our forecast of 12,432 tonnes. However, given that the G-9 mine is still working its way to full production some variability and start-up issues are not uncommon at this stage. Gold production of 3,355 ounces was slightly higher than our forecast, while silver production of 301,202 ounces was lower than expected. The lower than expected silver production was primarily attributable to the lack of a lead concentrate being produced during the quarter. Silver accounts for roughly 8% of our life-of-mine net smelter return (NSR) considering that Farallon only receives market prices on 25% of its silver, and receives US\$3.90/oz on the remaining 75% of its silver as per the funding agreement with Silver Wheaton (SLW-TSX, OUTPERFORM; price: C\$16.57). The company elected to focus on improving the copper recoveries, resulting in the lead recovery being suppressed within the bulk flotation circuit. Management anticipates that a lead concentrate will not be produced in 4Q09. We note that only an estimated 1% of the life-of-mine NSR from the G-9 mine is derived from lead sales. Mill throughput during the quarter was approximately 1,275 tonnes/day, as mill availability remained lower than expected. Key production performance statistics from the G-9 mine are shown in Exhibit 1.

Cash costs during the quarter of US\$0.45/lb of zinc were higher than our estimate of US\$0.36/lb, due to higher than expected smelting charges. We have increased our assumption for smelting fees going forward. Cash costs by month during the quarter were variable based on changes in production cost, smelter charges, and by-product credits, but ended the quarter in an encouraging fashion with a cash cost of US\$0.33/lb of zinc in the month of September.

During the quarter Farallon completed the development of an ore pass between the southern and northern ramps. This is expected to improve the efficiency of hauling ore from the Southeast zone in the mine to the mill. Additionally, the company completed access development in the Southeast zone from which a large portion of the mineralized material will be sourced in the coming periods. Currently there is access to 13 stoping areas, 9 of which are in the Southeast zone with the remainder in the North zone and the Western Extension.

**Exhibit 2: G-9 Production Performance**

	4Q08	1Q09	2Q09	3Q09
Tonnes milled	86,536	106,265	114,644	117,318
Tonnes/day	941	1,181	1,260	1,275
<b>Head Grades</b>				
Zinc (%)	8.8%	9.2%	11.0%	10.8%
Copper (%)	1.1%	1.1%	1.3%	1.5%
Lead (%)	1.3%	0.9%	1.2%	1.2%
Silver (g/t)	216	166	165	203
Gold (g/t)	2.8	2.3	2.3	2.7
<b>Recovery (%)</b>				
Zinc	74%	79%	77%	79%
Copper	33%	45%	55%	46%
Lead	12%	16%	20%	0%
Silver	28%	40%	47%	39%
Gold	28%	43%	52%	34%
<b>Metal in Concentrate Production</b>				
<u>Zinc Concentrate</u>				
Zinc (tonnes)	5,659	7,667	9,673	10,047
Silver (ounces)	107,673	120,145	122,971	170,388
Gold (ounces)	994	1,144	1,194	1,118
<u>Copper Concentrate</u>				
Copper (tonnes)	323	537	790	808
Silver (ounces)	36,732	67,273	103,041	129,339
Gold (ounces)	500	1,008	1,567	2,093
<u>Lead Concentrate</u>				
Lead (tonnes)	139	149	268	-
Silver (ounces)	25,111	41,901	63,376	-
Gold (ounces)	709	1,181	1,704	-
<b>Concentrate Grades</b>				
<u>Zinc Concentrate</u>				
Zinc (%)	48.5%	51.7%	52.1%	49%
Silver (g/t)	287	252	206	259
Gold (g/t)	2.65	2.40	2.00	1.70
<u>Copper Concentrate</u>				
Copper (%)	16.6%	17.8%	14.1%	16.5%
Silver (g/t)	588	694	572	822
Gold (g/t)	8.00	10.40	8.70	13.30
<u>Lead Concentrate</u>				
Lead (%)	17.0%	22.9%	20.9%	n/a
Silver (g/t)	956	2,005	1,540	n/a
Gold (g/t)	27.00	56.50	41.40	n/a

Source: Raymond James Ltd.

### **4Q09 Off to a Good Start**

The G-9 ramp-up improved heading into 4Q09. During the month of October the mill operated at 1,600 tonnes/day (7% above design capacity), and recovery rates showed improvement. Recovery rates for zinc, copper, silver, and gold during October were 83%, 55%, 47%, and 31%, respectively. This compares to 3Q09 zinc, copper, silver, and gold recovery rates of 79%, 46%, 39%, and 34%, respectively. Going forward, management is aiming to achieve recovery rates of 85% and 75% for zinc and copper exiting 4Q09. We are pleased to see progress being made with both throughput (mill availability) and recoveries as in our view these are the two largest near-term challenges faced by the mine. In particular, to-date copper recoveries have been lower-than-expected due to the presence of reagents in the process water that is re-circulated into the mill. Farallon has formed a Technical Support team with the objective of improving metallurgical recoveries through enhanced maintenance programs and closer monitoring of the concentration circuits.

### **Changes to our Estimates**

We have revised our NAV/share to C\$0.77 (previously C\$0.86). The change reflects the 3Q09 results including the update to the balance sheet, slightly higher Mexican corporate tax rates for 2010E through 2013E following changes recently approved by the Mexican congress, and an increase to our assumptions for smelter processing charges for the G-9 concentrate. Mexican corporate income tax rates are expected to rise to 30% from 28% in 2010 to 2012, before dropping to 29% in 2013, and then returning to the previous rate of 28% in 2014. The breakdown of our net asset value estimate for Farallon is shown in Exhibit 2.

**Exhibit 2: Farallon Mining Net Asset Value Estimate**

<b>Farallon Mining Ltd.</b>				
	Ownership	US\$ (mln)	US\$/shr	Valuation Basis
<b>Mines</b>				
G-9	100.0%	316.2	0.64	NPV @ 8% Real FY End 2009
<b>Projects</b>				
Other Campo Morado	100.0%	47.9	0.10	NPV @ 8% Real FY End 2009
Other	0.0%	-	0.00	
Other	0.0%	-	0.00	
<b>Other Assets</b>				
Cash and Marketable Securities		29.5	0.06	Balance sheet as at 4Q-09E
Working Cap net of Cash and ST Debt		1.1	0.00	Balance sheet as at 4Q-09E
Options		5.3	0.01	various expiry dates
<b>Debt and Obligations</b>				
Short Term Debt		(2.5)	-0.01	Balance sheet as at 4Q-09E
Long-term Debt		(26.7)	-0.05	Balance sheet as at 4Q-09E
Corporate SG&A		(27.7)	-0.06	DCF @ 8% Real FY-09E
Deferred Taxes		-	0.00	Balance sheet as at 4Q-09E
Provision for Contingencies		-	0.00	
<b>NET ASSET VALUE</b>		<b>343.1</b>	<b>\$0.70</b>	<b>C\$0.77</b>
Fully Diluted Shares Outstanding 492,823				
Basic Shares Outstanding 472,430				
Copper: '08A=US\$3.16/lb, '09E=US\$2.28/lb, '10E=US\$3.10/lb, '11E=US\$3.23/lb, L-T=US\$1.90/lb				
Lead: '08A=US\$0.95/lb, '09E=US\$0.68/lb, '10E=US\$0.62/lb, '11E=US\$0.62/lb, L-T=US\$0.55/lb				
Zinc: '08A=US\$0.86/lb, '09E=US\$0.75/lb, '10E=US\$1.30/lb, '11E=US\$0.90/lb, L-T=US\$0.85/lb				
Silver: '08A=US\$14.99/oz, '09E=US\$13.80/oz, '10E=US\$13.75/oz, '11E=US\$12.60/oz, L-T=US\$11.50/oz				
Gold: '08A=US\$873/oz, '09E=US\$975/oz, '10E=US\$1,050/oz, '11E=US\$950/oz, L-T=US\$800/oz				

Source: Raymond James Ltd.

We have revised our EPS estimates for 2009E, 2010E, and 2011E to -US\$0.01 (previously US\$0.00), US\$0.17 (previously US\$0.19), and US\$0.12 (previously US\$0.14), respectively. The change to our 2009E forecast primarily reflects the 3Q09 results, while the revised forecast for 2010E and 2011E is due to an increase in our assumption of smelter processing charges for the G-9 concentrate. The summary of the changes to our forecast are shown in Exhibit 3.

**Exhibit 3: Changes to our Forecast**

<b>New Estimates</b>	<b>2008A</b>	<b>2009E</b>	<b>2010E</b>	<b>2011E</b>
Zinc Production (tonnes)	0	37,388	46,428	53,060
Zinc Cash Cost (US\$/lb)	0.00	0.45	0.17	0.03
Total Production Cost (US\$/lb)	0.00	0.71	0.35	0.18
<b>EPS Basic (US\$)</b>	<b>(0.22)</b>	<b>(0.01)</b>	<b>0.17</b>	<b>0.12</b>
CEPS (US\$)	(0.18)	0.02	0.20	0.15
<b>Previous Estimates</b>	<b>2008A</b>	<b>2009E</b>	<b>2010E</b>	<b>2011E</b>
Zinc Production (tonnes)	0	37,763	46,428	53,060
Zinc Cash Cost (US\$/lb)	0.00	0.40	0.01	(0.11)
Total Production Cost (US\$/lb)	0.00	0.70	0.20	0.05
<b>EPS Basic (US\$)</b>	<b>(0.22)</b>	<b>0.00</b>	<b>0.19</b>	<b>0.14</b>
CEPS (US\$)	(0.18)	0.04	0.22	0.17
<b>% Change</b>	<b>2008A</b>	<b>2009E</b>	<b>2010E</b>	<b>2011E</b>
Zinc Production (tonnes)	N/A	(1%)	(0%)	0%
Zinc Cash Cost (US\$/lb)	N/A	14%	1093%	(129%)
Total Production Cost (US\$/lb)	N/A	0%	72%	283%
EPS Basic (US\$)	0%	(1012%)	(12%)	(14%)
CEPS (US\$)	0%	(57%)	(11%)	(13%)
<b>Copper Price Forecast (US\$/lb)</b>	<b>3.16</b>	<b>2.28</b>	<b>3.10</b>	<b>3.23</b>

Source: Raymond James Ltd.

## Positive Investment Attributes

We maintain our positive outlook on Farallon's shares. The company has a number of upcoming initiatives which we expect will continue to act as potential positive catalysts for the stock. We anticipate the following future catalysts:

- **Resumption of exploration** – Farallon recently resumed exploration drilling at its Campo Morado property. In an October 8, 2009 press release the company stated that it will spend approximately US\$2.7 million on a 20,000 metre drilling campaign over the next two quarters. We expect that the company's first order of business will be to drill prospective targets in the area around G-9 as a first step towards increasing the resource tonnage. We anticipate drilling adjacent to the North Zone, and at the horizon of the Abajo Zone (the North and Abajo Zones are two of the three significant areas comprising the G-9 mineral resource). We note that Farallon's last drilling program, in 2008, did meet with success as it discovered a new sulphide lens called the West Extension (northwest of the North Zone and closer to the San Augustin decline ramp), and it extended the Abajo Zone to the north and the North Zone to the west. The Western Extension area has already provided feed for the mill. Previous drilling has also found indications of deeper mineralization in the Abajo Zone.
- **Preliminary economic assessment (PEA) for satellite deposits at G-9** – Farallon is currently in the process of preparing a PEA on the El Largo, Naranjo, Reforma, and El Rey deposits at Campo Morado. These deposits are located north of the operating G-9 mine, and could potentially leverage the existing mill infrastructure to extend the mine life. The El Largo deposit is expected to be accessible from the existing underground workings with approximately 500 metres of further development, while the other deposits are within roughly 5 km of the mill.
- **Increasing production by expanding the mill** – Farallon is presently ramping-up production at the G-9 mine. Mill throughput was 1,275 tonnes/day in 3Q09, and was approximately 1,600 tonnes/day in October 2009 (7% above the design capacity of 1,500 tonnes/day). The company is planning to increase the throughput rate to 2,000 tonnes/day by mid-2010. The company has hired Axxent Engineering for the expansion project's engineering, procurement, and construction management services. Axxent is a Canadian-based engineering consultant that has previously performed work for Farallon at Campo Morado, as well as Taseko Mines (TKO-TSX, OUTPERFORM, price: C\$3.43) for its Prosperity project, and HudBay Minerals' (HBM-TSX) Snow Lake concentrator upgrade.

**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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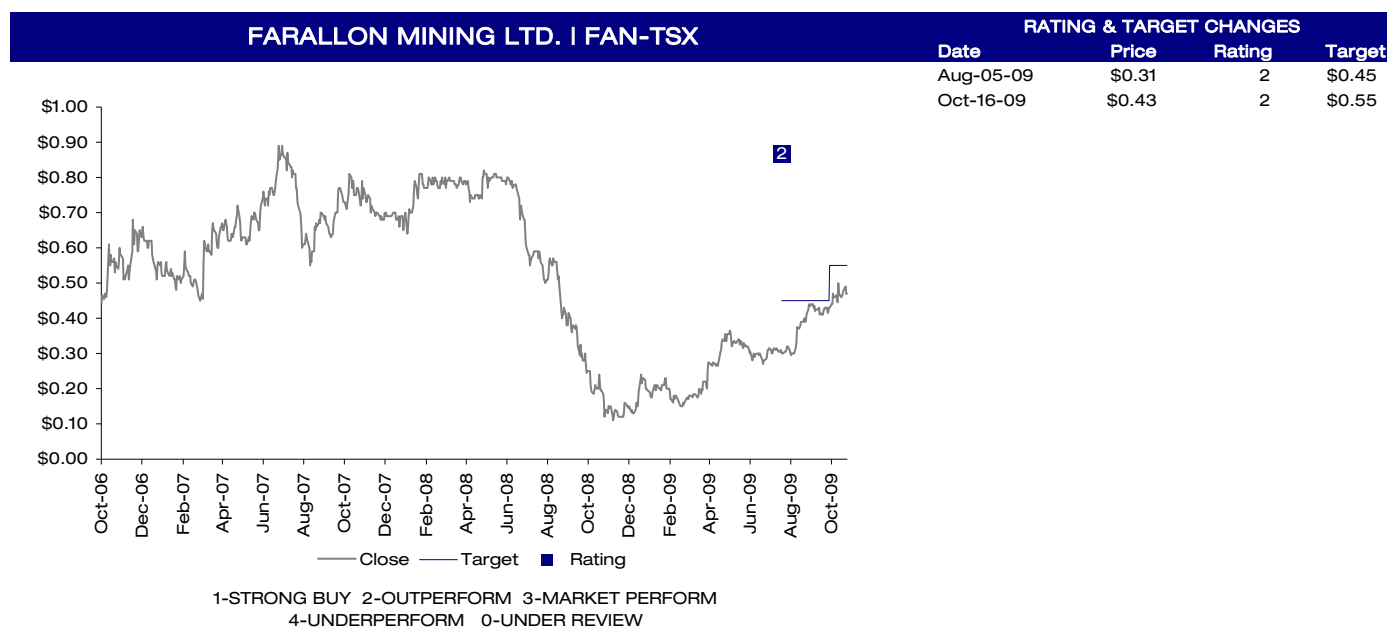
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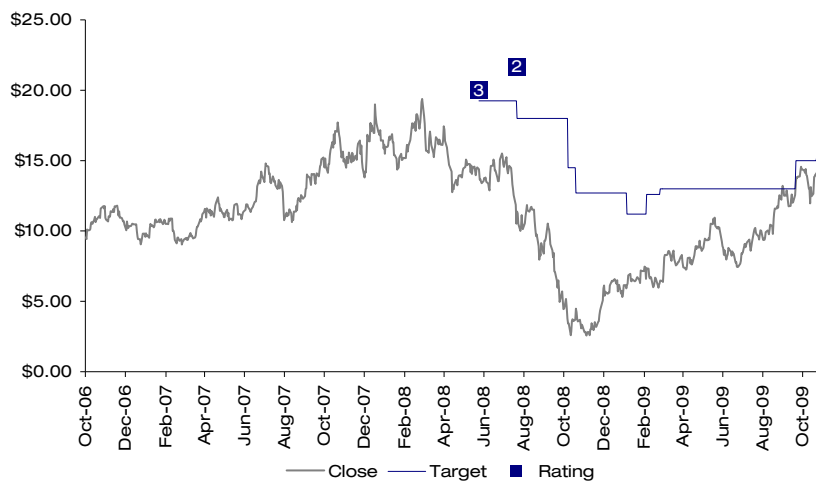
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COMPANY	SYMBOL	EXCHANGE	DISCLOSURES
Farallon Mining Ltd.	FAN	TSX	1a, 1b, 1e, 6
Silver Wheaton	SLW	NYSE, TSX	1a, 1b, 1e
Taseko Mines Ltd.	TKO, TGB	TSX, AMEX	1a, 1b, 1e, 6



**SILVER WHEATON | SLW-NYSE**

**RATING & TARGET CHANGES**

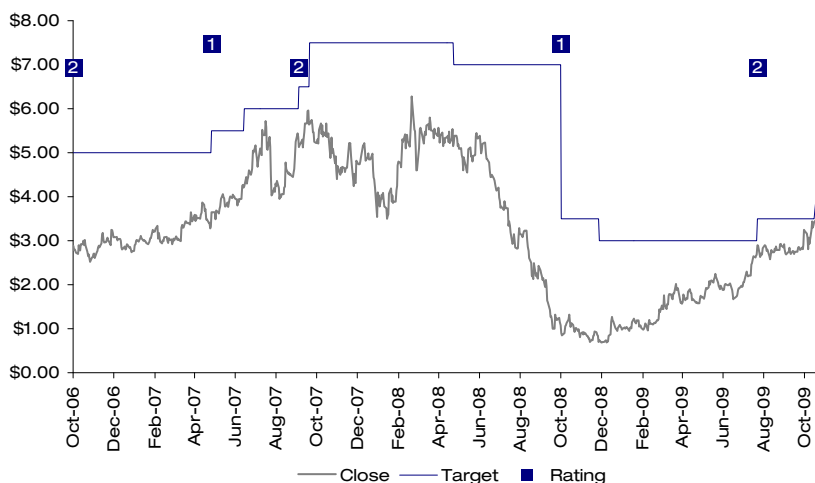


Date	Price	Rating	Target
Jun-09-08	\$14.17	3	\$19.25
Aug-06-08	\$10.52	2	\$18.00
Oct-23-08	\$4.65	2	\$14.50
Nov-04-08	\$3.70	2	\$12.70
Jan-21-09	\$6.15	2	\$11.20
Feb-20-09	\$6.59	2	\$12.60
Mar-13-09	\$6.29	2	\$13.00
Oct-06-09	\$12.55	2	\$15.00
Nov-11-09	\$14.97	2	\$16.65

1-STRONG BUY 2-OUTPERFORM 3-MARKET PERFORM  
4-UNDERPERFORM 0-UNDER REVIEW

**TASEKO MINES | TKO-TSX**

**RATING & TARGET CHANGES**



Date	Price	Rating	Target
Apr-29-05	\$1.49	2	\$2.20
Jan-20-06	\$1.76	2	\$2.50
Mar-22-06	\$2.05	2	\$3.00
Apr-13-06	\$3.20	2	\$4.50
Oct-19-06	\$2.73	2	\$5.00
Feb-20-07	\$3.20	2	\$5.00
May-18-07	\$3.33	1	\$5.50
Jul-06-07	\$4.21	1	\$6.00
Sep-26-07	\$5.36	2	\$6.50
Oct-12-07	\$5.96	2	\$7.50
Nov-05-07	\$5.38	2	\$7.50
May-15-08	\$5.15	2	\$7.00
Oct-23-08	\$1.15	1	\$3.50
Dec-19-08	\$0.70	1	\$3.00
Aug-13-09	\$2.68	2	\$3.50
Nov-09-09	\$3.35	2	\$4.00

1-STRONG BUY 2-OUTPERFORM 3-MARKET PERFORM  
4-UNDERPERFORM 0-UNDER REVIEW