

Farallon Mining Ltd.

FAN-TSX

4Q09 Production In-line; Costs to be a Focus Going Forward

Event

Farallon reported the 4Q09 production results from its G-9 mine.

Action

We recommend buying Farallon Mining's shares.

Analysis

- **Making headway on throughput and recoveries...** – In 4Q09 Farallon made progress on increasing throughput and recoveries. Mill throughput averaged 1,552 tonnes/day, up 22% from 3Q09. Recoveries also improved quarter-over-quarter, with zinc at 80% (up from 79%), and copper at 56% (up from 46%). By our estimates payable metal production during the quarter was 9,000 tonnes of zinc (RJ 9,900 tonnes), 1,100 tonnes of copper (RJ 1,200 tonnes), 311,000 ounces of silver (RJ 381,000 ounces), and 3,400 ounces of gold (RJ 3,700 ounces).
- **...More work to do on costs** – While the cash cost calculation has not been finalized, management estimated it to be US\$0.44/lb of zinc for the quarter. This is roughly on par with 3Q09 at US\$0.45/lb, however, it was worse than our forecast of US\$0.31/lb. The greater than expected cash costs were attributable to high site costs due to the use of contractors and maintenance spending to bring the concentrator to steady state. These incremental costs are anticipated to taper-off going forward, however, we have incorporated a more conservative timeline for the winding down of these expenses heading into 2010.
- **Forecast changes** – We have revised our EPS estimates for 2009E and 2010E to -US\$0.03 (prev. -US\$0.01), and US\$0.17 (prev. US\$0.19), respectively. Our updated NAV estimate is C\$1.05 (prev. C\$1.09).
- **4Q09 financial results** – The full results are to be released on or about Mar-30-10, and a conference call is planned for Mar-31-10.

Valuation

Farallon's shares trade at a P/NAV of 0.53x. This compares to the weighted average of base metal producers of 0.67x. Our target price of C\$0.75 is based on a 0.70x multiple applied to our NAV of C\$1.05 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\$)	0.56
Total Return to Target	34%

MARKET DATA

Market Capitalization (US\$mIn)	252
Current Net Debt (US\$mIn) (3Q09A)	18
Enterprise Value (US\$mIn) (2009E)	271
Basic Shares Outstanding (mln)	472.4
Avg Daily Dollar Volume (3mo, mln)	n/a
52 Week Range (C\$)	\$0.12 - \$0.65

KEY FINANCIAL METRICS

FY-Dec 31	2008A	2009E	2010E
EPS (US\$)	(0.22)	(0.03)	0.17
P/E (x)	nmf	nmf	3.2
EPS - 1Q (US\$)	nmf	-0.02	0.02
EPS - 2Q (US\$)	nmf	-0.02	0.03
EPS - 3Q (US\$)	nmf	-0.00	0.05
EPS - 4Q (US\$)	nmf	0.01	0.06
NAVPS (C\$)		1.05	
P/NAV(x)		0.53	
Revenue (US\$mIn)	nmf	85	162
EBITDA (US\$mIn)	nmf	9	107
Zn Prod'n (000's MT)	-	32.3	46.0
Zn Cash Cost (US\$/lb)	-	0.46	0.11

* After by-product credits

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

4Q09 Production Shows Ramp-Up Progress, Still Work to do on Costs

The key production performance statistics from the G-9 mine are shown in Exhibit 1. Payable metal production was not reported but we estimate it to be 9,000 tonnes of zinc, 1,100 tonnes of copper, 311,000 ounces of silver, and 3,400 ounces of gold.

Exhibit 1: G-9 Production Performance

	4Q08	1Q09	2Q09	3Q09	4Q09
Tonnes milled	86,536	106,265	114,644	117,318	142,752
Tonnes/day	941	1,181	1,260	1,275	1,552
Head Grades					
Zinc (%)	8.8%	9.2%	11.0%	10.8%	9.3%
Copper (%)	1.1%	1.1%	1.3%	1.5%	1.4%
Lead (%)	1.3%	0.9%	1.2%	1.2%	1.1%
Silver (g/t)	216	166	165	203	182
Gold (g/t)	2.8	2.3	2.3	2.7	3.0
Recovery (%)					
Zinc	74%	79%	77%	79%	80%
Copper	33%	45%	55%	46%	56%
Lead	12%	16%	20%	0%	0%
Silver	28%	40%	47%	39%	47%
Gold	28%	43%	52%	34%	32%
Metal in Concentrate Production					
<u>Zinc Concentrate</u>					
Zinc (tonnes)	5,659	7,667	9,673	10,047	10,598
Silver (ounces)	107,673	120,145	122,971	170,388	204,713
Gold (ounces)	994	1,144	1,194	1,118	1,665
<u>Copper Concentrate</u>					
Copper (tonnes)	323	537	790	808	1,102
Silver (ounces)	36,732	67,273	103,041	129,339	176,144
Gold (ounces)	500	1,008	1,567	2,093	2,531
<u>Lead Concentrate</u>					
Lead (tonnes)	139	149	268	-	-
Silver (ounces)	25,111	41,901	63,376	-	-
Gold (ounces)	709	1,181	1,704	-	-
Concentrate Grades					
<u>Zinc Concentrate</u>					
Zinc (%)	48.5%	51.7%	52.1%	49%	49%
Silver (g/t)	287	252	206	259	295
Gold (g/t)	2.65	2.40	2.00	1.70	2.40
<u>Copper Concentrate</u>					
Copper (%)	16.6%	17.8%	14.1%	16.5%	15.4%
Silver (g/t)	588	694	572	822	766
Gold (g/t)	8.00	10.40	8.70	13.30	11.00
<u>Lead Concentrate</u>					
Lead (%)	17.0%	22.9%	20.9%	n/a	n/a
Silver (g/t)	956	2,005	1,540	n/a	n/a
Gold (g/t)	27.00	56.50	41.40	n/a	n/a

Source: Raymond James Ltd.

Changes to our Estimates

We have revised our NAV/share to C\$1.05 (previously C\$1.09). The change reflects the 4Q09 production results, and an increase to our operating cost assumptions for 2010E. The breakdown of our net asset value estimate for Farallon is shown in Exhibit 2.

Exhibit 2: Farallon Mining Net Asset Value Estimate

Farallon Mining Ltd.				
	Ownership	US\$ (mln)	US\$/shr	Valuation Basis
Mines				
G-9	100.0%	407.3	0.83	NPV @ 8% Real FY End 2010
Projects				
Other Campo Morado	100.0%	86.3	0.18	NPV @ 8% Real FY End 2010
Other	0.0%	-	0.00	
Other	0.0%	-	0.00	
Other Assets				
Cash and Marketable Securities		70.8	0.14	Balance sheet as at Q4 10E
Working Cap net of Cash and ST Debt		1.1	0.00	Balance sheet as at Q4 10E
Options		5.9	0.01	various expiry dates
Debt and Obligations				
Short Term Debt		(2.5)	(0.01)	Balance sheet as at Q4 10E
Long-term Debt		(21.7)	(0.04)	Balance sheet as at Q4 10E
Corporate SG&A		(29.6)	(0.06)	DCF @ 8% Real FY-09E
Deferred Taxes		-	0.00	Balance sheet as at Q4 10E
Provision for Contingencies		-	0.00	
NET ASSET VALUE		517.5	\$1.05	C\$1.05
Fully Diluted Shares Outstanding	492,823			
Basic Shares Outstanding	472,430			
Copper: '08A=US\$3.16/lb, '09E=US\$2.34/lb, '10E=US\$3.56/lb, '11E=US\$3.80/lb, L-T=US\$2.50/lb				
Lead: '08A=US\$0.95/lb, '09E=US\$0.78/lb, '10E=US\$1.10/lb, '11E=US\$1.15/lb, L-T=US\$0.72/lb				
Zinc: '08A=US\$0.86/lb, '09E=US\$0.75/lb, '10E=US\$1.30/lb, '11E=US\$1.33/lb, L-T=US\$1.10/lb				
Silver: '08A=US\$14.99/oz, '09E=US\$14.68/oz, '10E=US\$19.00/oz, '11E=US\$18.00/oz, L-T=US\$13.00/oz				
Gold: '08A=US\$873/oz, '09E=US\$973/oz, '10E=US\$1,250/oz, '11E=US\$1,250/oz, L-T=US\$900/oz				

Source: Raymond James Ltd.

We have revised our EPS estimates for 2009E and 2010E to -US\$0.03 (previously -US\$0.01), and US\$0.17 (previously US\$0.19), respectively. The change to our 2009E forecast reflects the 4Q09 production results. The 2010E revision is primarily due to an increase to our operating cost assumptions. The summary of the changes to our forecast are shown in Exhibit 3.

Exhibit 3: Changes to our Forecast

New Estimates	2008A	2009E	2010E	2011E
Zinc Production (tonnes)	0	32,258	46,020	53,060
Zinc Cash Cost (US\$/lb)	0.00	0.46	0.11	(0.08)
Total Production Cost (US\$/lb)	0.00	0.77	0.32	0.07
EPS Basic (US\$)	(0.22)	(0.03)	0.17	0.21
CEPS (US\$)	(0.18)	0.01	0.19	0.24
Previous Estimates	2008A	2009E	2010E	2011E
Zinc Production (tonnes)	0	33,145	46,428	53,060
Zinc Cash Cost (US\$/lb)	0.00	0.43	0.03	(0.08)
Total Production Cost (US\$/lb)	0.00	0.69	0.21	0.07
EPS Basic (US\$)	(0.22)	(0.01)	0.19	0.21
CEPS (US\$)	(0.18)	0.02	0.22	0.24
% Change	2008A	2009E	2010E	2011E
Zinc Production (tonnes)	N/A	(3%)	(1%)	0%
Zinc Cash Cost (US\$/lb)	N/A	8%	306%	0%
Total Production Cost (US\$/lb)	N/A	10%	52%	5%
EPS Basic (US\$)	0%	88%	(14%)	(0%)
CEPS (US\$)	0%	(64%)	(13%)	(0%)
Zinc Price Forecast (US\$/lb)	0.86	0.75	1.30	1.33

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 positive catalysts for the stock. We anticipate the following future catalysts:

- **Exploration potential** – We expect Farallon to release the second set of drill results from the recently restarted exploration program at the G-9 deposit in 1Q10. The first batch of drill results were released in December 2009 and identified continuity of mineralization, and a number of new high-grade targets. Importantly, many of the focus areas are close to the company's current underground workings. In our view there is potential to grow the resource at G-9 and extend the mine life. We estimate that at a zinc price of US\$1.10/lb adding one additional year to the G-9 mine life would increase our NAV by 7%, or C\$0.08 per share.
- **Increasing production by expanding the mill** – Farallon is presently ramping-up production at the G-9 mine. Mill throughput was 1,550 tonnes/day in 4Q09, 3% 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, and has hired Axxent Engineering for the expansion project's engineering, procurement, and construction management services. Axxent is a Canada-based engineering consultant that has previously performed work for Farallon at Campo Morado, as well as Taseko Mines (TKO-T, MARKET PERFORM, price: C\$5.03) 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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COMPANY	SYMBOL	EXCHANGE	DISCLOSURES
Farallon Mining Ltd.	FAN	TSX	1a, 1b, 1e, 6
Taseko Mines Ltd.	TKO, TGB	TSX, AMEX	1a, 1b, 1e, 6

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RATING & TARGET CHANGES

Date	Price	Rating	Target
Aug-05-09	\$0.31	2	\$0.45
Oct-16-09	\$0.43	2	\$0.55
Dec-01-09	\$0.43	2	\$0.75

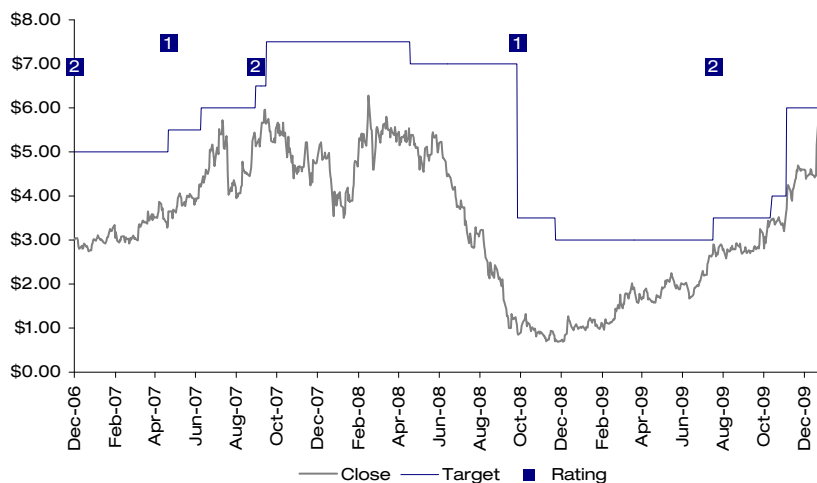


1-STRONG BUY 2-OUTPERFORM 3-MARKET PERFORM
4-UNDERPERFORM 0-UNDER REVIEW

TASEKO MINES | TKO-TSX

RATING & TARGET CHANGES

Date	Price	Rating	Target
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
Dec-01-09	\$3.20	2	\$6.00



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