

## Silver Lake Resources (SLR)

Recommendation: Speculative Buy

27 January 2009

### December Quarter Report – Production slightly ahead of forecast

- SLR's December quarter's gold production of 9,965oz (September quarter: 8,670oz) exceeded the company's forecast. Open pit mining at Christmas Flats is expected to start in the March quarter.
- Following the release of the December Quarter Report, we have reduced our average estimated mined grade (to 10g/t), increased our estimated unit cash costs excluding royalties to A\$519/oz for the 2010FY (2008 December quarter: A\$684/oz), rescheduled open cut developments and adjusted our gold price assumptions.
- As a result of the model changes, our base case valuation for SLR has been reduced from \$0.50 per share to \$0.46 per share (fully diluted, allowing for 27m unlisted options). Our base case valuation is based on: a 5 year Mount Monger mine life to 2013 (at 40–50kozpa); excluding any value for the Murchison Goldfield (pre-feasibility study outcome in the current quarter); and using a 5% discount rate. At a 10% discount rate, our valuation is 42 cents per share.
- At 20 cents per share, we retain a Speculative Buy recommendation. Risks include establishing sufficient resources – to underpin our base case and upside case valuation estimates – plus all the usual technical risks attached to narrow vein underground mining and gold price risk. High equity market risk aversion is also likely to constrain share price gains (for small cap stocks generally). The company appears to have a very capable Board (all ex-WMC) and management.

Share price: \$0.20

52 week price range: \$0.13/\$0.42

Market capitalisation (\$m): 31

Year ending 30 June	2007	2008	2009	2010	2011
	Act	Act	Est	Est	Est
Adjusted Profit	-7.2	-3.7	12.0	22.9	16.8
EPS (fully diluted) <sup>1</sup> (cps)	-4.0	-2.0	6.6	12.7	9.3
P/E ratio (x)	na	na	3.0	1.6	2.2
DPS (c)	0.0	0.0	0.0	0.0	0.0
<b>Assumptions</b>					
Gold produced (koz)	0	6	40	48	50
\$A/US realized	0.788	0.950	0.715	0.665	0.710
Gold (US\$/oz) realized	638	890	832	890	810

### December Quarter Report

December quarter's gold production of 9,965oz (September quarter: 8,670oz) exceeded the company's forecast due to a larger than expected increase in ore hoisted. At the Daisy Milano Mine (50 km SE of Kalgoorlie), average mined grade was 9.7 g/t Au (September quarter: 12.0g/t Au) with monthly ore grades ranging between 7.7 g/t Au and

11.5 g/t Au. The mined grade is likely to be variable month-to-month, given a high nugget effect within the lodes. Approximately 48% of the ounces produced came from stoping activities with the balance from level development.

Results to date indicate that gold production can be sustained within the expected 35–40kozpa range.

This production target has been enhanced by new development along levels 21 through 23 to the south of the dolerite dyke which has revealed a new high-grade shoot of considerable strike extent.

Site operating costs for the quarter were A\$684/oz (September quarter: A\$687/oz). These were higher than we had expected. Nevertheless, an average realized price of A\$1,138/oz offered a relatively good margin.

The Company has implemented measures to improve operating costs through:

- Improving productivity and selective mining; and
- Increasing utilisation of the Lakewood Gold Processing Facility (LGPF) including the expected start of open pit mining at Christmas Flats in the March quarter. (Current mill capacity is 300kt of hard and soft ore or 200-220kt for hard ore feed only.) Open pit mining studies are also scheduled for commencement at Costello, Magic and Lorna Doone. Future production from these sources would ensure that the mill would be fully loaded for at least the next three years.

Silver Lake took advantage of spare mill capacity and the high gold price during the quarter to treat 4,500t of stockpiled low-grade ore at 2.0 g/t for 289oz.

SLR is also reviewing opportunities to optimise the utilisation of the LGPF through project acquisitions, joint ventures or toll treatment arrangements.

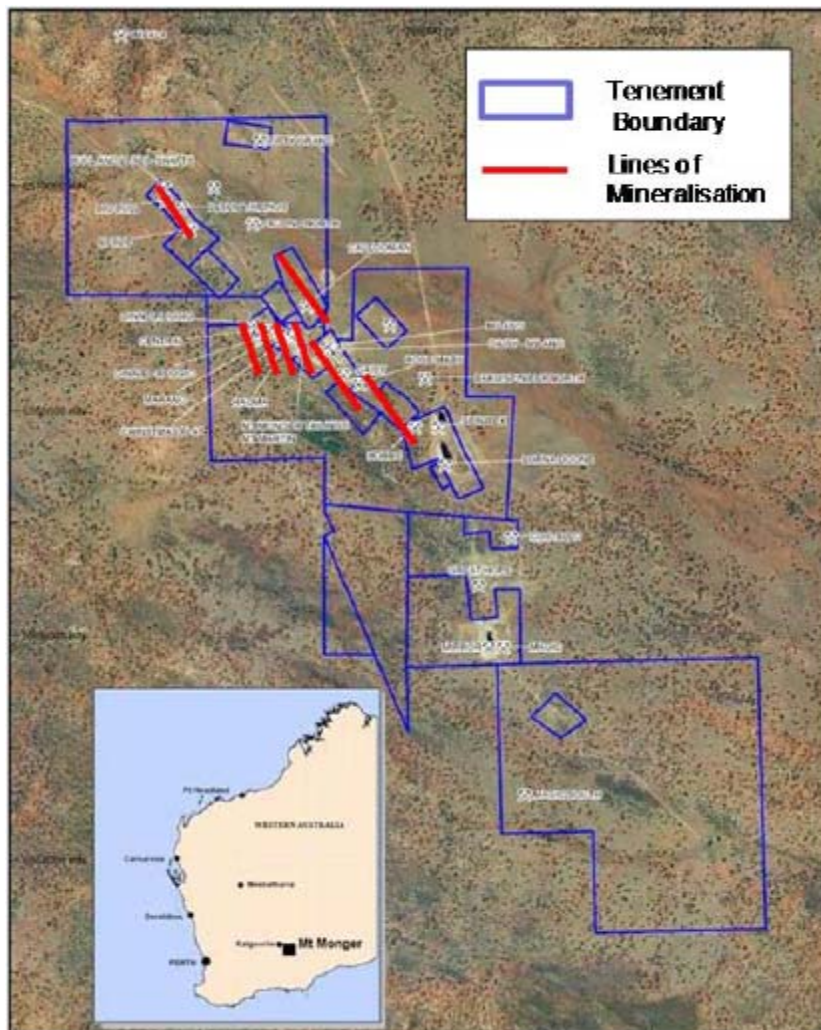
During the March 2009 quarter, work will start on:

- Extending the Daisy Milano decline (350m, estimated cost: \$1.8m) to provide a drilling platform to test the extent of the significant high grade shoot south of the dolerite dyke below the 23 level.
- A 2 metre tailings dam lift (estimated cost: \$0.5m) to provide for the next 12 to 18 months' production will be conducted at LGPF during the quarter.

At 31 December 2008, SLR had cash and cash equivalents of \$6.67m, comprising \$5.83m in cash and \$0.84m in bullion on hand.

SLR remains unhedged.

### Silver Lake's Mount Monger Tenements



## Mount Monger - Resources

Calculation of a new resource for the **Magic deposit** has increased the total Mount Monger resource base by 16% to 1.2mt at 9.7 g/t Au for 374,900oz.

The Company has submitted all of the required regulatory documentation to enable commencement of open pit mining at Christmas Flats. Project approvals are expected in the March 2009 quarter.

**Mining studies for open pit production at Costello, Lorna Doone and Magic will commence in the coming quarter.** These deposits have a combined total resource of 493,200 tonnes at 4.72 g/t Au for 74,800 oz.

## Mount Monger - Background

Silver Lake poured the first gold at its Lakewood Gold Processing Facility in April 2008 after commencing operations at Daisy Milano in December 2007. It follows the acquisition of Perilya's gold assets (including the Daisy Milano mine and most of the Mount Monger Goldfield) in August 2007 in a deal (\$7.5m cash, \$6m in SLR shares and a minor royalty) which increasingly appears highly favourable to SLR.

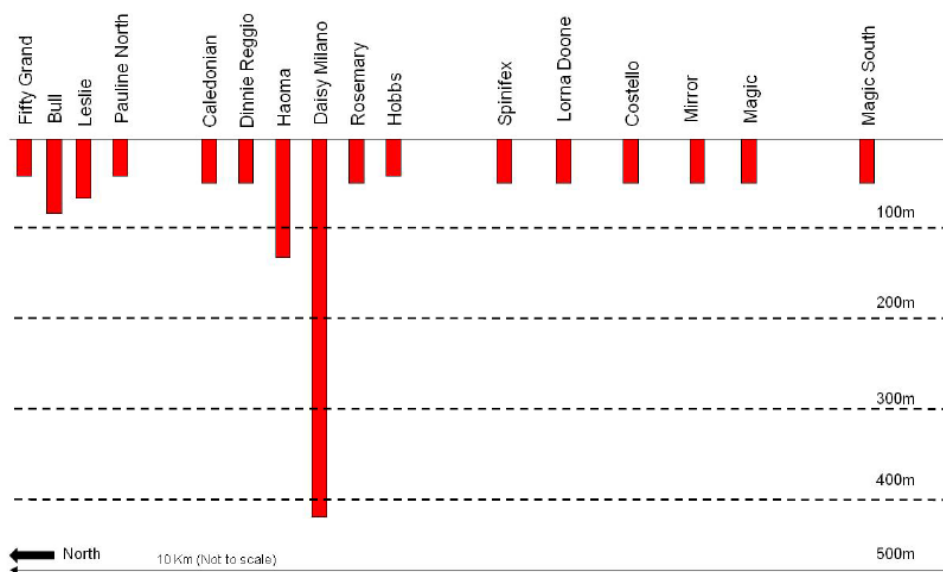
Silver Lake's Mount Monger Operation, including the Daisy Milano mine, is located 50 km SE of Kalgoorlie. The separate purchase (30 November 2007) and refurbishment of the Lakewood Gold Processing Facility (cost: \$2.4m; plus \$4.6m included installation of a gravity circuit), located 5 km east of Kalgoorlie and 45 km from Daisy Milano, adds further value (replacement cost would now be: \$25m, plus extended delays for mill delivery).

SLR has access to a very large drilling data base for the Mount Monger Goldfield, yet only 3% of drillholes extend deeper than 100m. A due diligence report (AngloGold, 2003) had indicated a potential gold inventory of 2.0to 4.5Moz.

SLR is the first company to undertake a comprehensive, systematic exploration programme over the entire Mount Monger tenement package (acquired in November 2007) and is **targeting 2Moz in resources across the area.**

At this stage there is still some uncertainty on realized mined grades at Daisy Milano. SLR's monthly mined grades are typically 7-15g/t, based on selective mining with minimal dilution (up to 2m widths).

## Multi Mine Operation & Potential at Depth



Source: Silver Lake Resources

Historic Mined Grade	
Daisy Main	28.4 g/t
Milano (Upper)	33.8 g/t
Milano (Lower)	15.6 g/t
Rosemary	27.4 g/t
Haoma	28.9 g/t
Dinnie Reggio	32.6 g/t
Caledonian	7.9 g/t
Pauline	11.8 g/t
Leslie	21.8 g/t
Bull	28.6 g/t
<b>Average</b>	<b>23.7 g/t</b>

## Murchison Goldfield

The Company is currently reviewing the results of a **pre-feasibility study into low capital start-up options for the Murchison project** and expects to make an announcement regarding the outcome of this study during the current March quarter.

The Murchison Goldfield includes Tuckabianna, Comet, Moyage and Rothsay deposits.

An update of the Comet resource estimate has resulted in an increase in the overall resource base for the Murchison project to 7,821,800 t at 3.8 g/t Au for 965,400 oz.

We assume the Murchison projects have nil value in our base case valuation (other than the value of the exploration/evaluation expenditure).

<b>Mount Monger GoldField</b>		<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Daisy-Milano ore milled	mt	0.021	0.125	0.125	0.125
	g/tAu	10.2	10.0	10.0	10.0
Christmas Flats	mt		0.025	0.050	0.050
	g/tAu		3.5	3.5	3.5
Costello, Magic & Lorna Doone	mt			0.040	0.050
	g/tAu			4.0	4.0
Total Ore Milled	mt	0.021	0.150	0.215	0.225
Recovery		84.0%	94.0%	95.0%	95.0%
<b>Gold Production</b>	<b>koz</b>	<b>5.8</b>	<b>40.5</b>	<b>48.5</b>	<b>49.7</b>
Gold Price	\$US/oz	890	832	890	810
	\$A/oz	935	1164	1338	1141
Cash costs excl royalties	\$A/oz	719	694	519	494
Cash costs incl royalties	\$A/oz	731	723	553	522
Total costs excl royalties	\$A/oz	855	792	622	614
Total costs incl royalties	\$A/oz	868	821	655	643

<b>Profit / (Loss)</b>	<b>\$Am</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Revenue		2.9	47.1	64.9	56.7
Mining, Transport, Admin		-3.4	-22.8	-19.8	-18.9
Milling		-0.8	-5.3	-5.4	-5.6
Operating Surplus		-1.2	19.0	39.7	32.1
WA State Gov. Royalty		-0.1	-1.2	-1.6	-1.4
Depreciation/amort		-0.8	-4.0	-5.0	-6.0
Other		-1.6	-1.0	-1.0	-1.0
Pre-tax profit		-3.7	12.9	32.1	23.8
Tax expense		0.0	-0.9	-9.2	-7.0
<b>Adjusted Profit</b>		<b>-3.7</b>	<b>12.0</b>	<b>22.9</b>	<b>16.8</b>

<b>Cash Flow</b>	<b>\$Am</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
Operating Surplus		-1.2	19.0	39.7	32.1
Capital Expenditure		-19.0	-4.0	-4.0	-3.0
WA State Govt Royalty		-0.1	-1.2	-1.6	-1.4
Exploration/evaluation expenditure <sup>1</sup>		-3.2	-6.2	-4.5	-2.2
Tax Paid		0.0	-0.9	-9.2	-7.0
<b>Net Cash Flow</b>		<b>-23.5</b>	<b>6.8</b>	<b>20.4</b>	<b>18.6</b>

<sup>1</sup> Includes planned \$5.7m Murchison expenditures - excluded from base case valuation.

## Valuation

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**As a result of the model changes, our base case valuation for SLR has been reduced from \$0.50 per share to \$0.46 per share (fully diluted, allowing for 27m unlisted options). Our base case valuation is based on: a 5 year Mount Monger mine life to 2013 (at 40-50kozpa); excluding any value for the Murchison Goldfield; and using a 5% discount rate. At a 10% discount rate, our valuation is 42 cents per share.**

<b>Valuation at 31/12/08</b>	<b>A\$m</b>	<b>NPV/share</b>
Mount Monger Gold Mine <sup>1</sup>	76	0.42
Net Cash	7	0.04
Capitalised Corporate Costs	-8	-0.04
Exploration - Additional Value <sup>2</sup>	4	0.02
Lakewood Plant - Residual Value	4	0.02
<b>Base Case Valuation</b>	<b>83</b>	<b>0.46</b>
Murchison Goldfield	35	0.19
Upside Valuation	117	0.65

<sup>1</sup> Assumes 300koz of mineable reserves (total 5 year mine life)

<sup>2</sup> Additional discounted value of exploration expenditure - targeting 2Moz in resources at Mount Monger

## Gold Price Outlook

Gold rose for an eighth consecutive year in 2008, gaining 5.8% – unlike most other asset classes which had double-digit losses.

We expect US\$ gold prices will continue to be mostly influenced by movements in the US\$ and anticipation of future exchange rates. In particular, the gold price continues to be supported by expectations of a declining US\$ in response to the planned ramp up in government spending. Stagnant mine output, limited official sector sales, robust ETF gold holdings, perceived "safe haven" status and retail demand should also support prices.

Interestingly, we note that the US\$ gold price has risen sharply over the past two weeks (from US\$810/oz to US\$900/oz), whilst the Euro/US\$ rate has been broadly steady.

However, there are other offsetting factors which may put some downward pressure on gold prices, at least in the next six months, including: further weakening in euro zone growth (relative to the US), any intensifying of risk aversion and consequent deleveraging (across all asset classes, perhaps still impacting gold less than others), deflationary pressures near term, plus the current net long position in gold.

**F.W. Holst & Co. Pty. Ltd.**

**Rob Craigie**

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