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Silver Lake Resources (SLR)

Recommendation: Buy 5 August 2009

Discovery of Daisy East, Emma & the extension of the Rosemary lode

- The discovery of Daisy East, Emma and the extension of the Rosemary lode (reported on 27 July 2009) in close proximity to the Daisy Milano infrastructure support the company's view (and ours) of a potentially larger resource base at Mount Monger, compared to the just reported 390koz in the June 2009 resource inventory (released 3 August 2009).
- SLR has reported a full year after tax profit of $10.7m (3 August 2009) after releasing a pre-tax profit of $13.6m in its June Quarter Report (released 21 July 2009). The company decided to defer a dividend given: the absence of any franking credits; a number of immediate value adding projects; and a desire to maintain a strong balance sheet. (We had expected a maiden 1 cps final 2009 dividend.)
- Daisy Milano's mined grade averaged 8.9 g/t Au for the June quarter which was lower than the March quarter (11.2g/t;) and the full year (10.0g/t) due to ~80% of production coming from lower grade mining areas north of the dolerite dyke. A 40,000oz high grade stoping panel is being set up predominately south of the dolerite dyke with production commencing in the September 2009 quarter.
- SLR plans to complete a Stage 1 expansion of the Lakewood Gold Processing Facility (LGPF) in January 2010 (estimated capital cost: ~$4m). Our base case valuation, which now includes a Stage 1 expansion (an expansion was previously in our upside case), has increased to $0.90/share. It is based on a five year mine life at Mount Monger (assuming a resource/reserve base of 540koz); mill throughput of just under 500ktpa for 2011-2014FY's; and using a 5% discount rate.
- Our upside case ($1.09/share) includes a modest valuation for SLR's interest in the Murchison Goldfield, where the company continues to review low capital milling options for the project.
- Our recommendation for SLR was changed to Buy (at $0.645/share on 24 July 2009; previously: Speculative Buy) to reflect progressively lower operating and financial risks. We still rate SLR as relatively High Risk given all the usual risks attached to narrow vein underground mining and realised gold prices. The company has a very capable Board (all ex-WMC) and management.

Share price:	$0.705				
52 week price range:	$0.13/$0.89				
Market capitalisation ($m):	108				
Year ending 30 June	**2008**	**2009**	**2010**	**2011**	**2012**
	Act	Act	Est	Est	Est
Adjusted Profit	-3.7	10.7	15.6	27.8	23.2
EPS (fully diluted) (cps)	-3.4	6.9	8.7	15.5	12.9
P/E ratio (x)	n/a	10.2	8.1	4.6	5.5
DPS (c)	0.0	0.0	0.0	3.0	3.0
Yield (%)	0.0%	0.0%	0.0%	4.3%	4.3%
Assumptions					
Gold produced (koz)	6	47	63	111	120
$A/US realised	0.950	0.746	0.780	0.760	0.750
Gold (US$/oz) realised	890	896	933	850	775

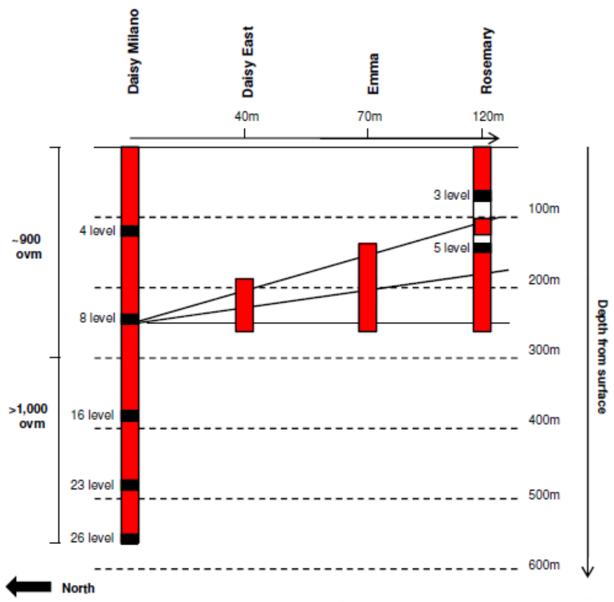
Targeting Extensions to Rosemary

SLR had undertaken a 10 hole underground programme in May 2009 from the Daisy Milano mine 8 level (~250 metres below the surface) targeting extensions to the Rosemary orebody located ~120 metres to the east of Daisy Milano.

The company has reported (on 27 July 2009) that the programme not only intercepted the extension of the Rosemary lode but also made two new discoveries. **Daisy East and Emma were intersected ~40 and ~70 metres from Daisy Milano respectively** (after re-surveying the holes). All three lodes are open along strike as well as up and down dip. The structures contain typical Daisy Milano style narrow vein mineralisation with sericite pyrite alteration with some intercepts containing visible gold. The area defined by this initial programme is 150 lateral metres by 40 vertical metres.

SLR has noted that the Daisy Milano is currently endowed with >1,000 ounces per vertical metre <u>and the next drilling programme could prove up similar endowment for each of the three parallel ore lodes</u>. This would be a very good outcome!

New Discoveries – Open Up/Down Dip



Schematic view: Not to scale
OVM: Ounces per vertical metre

Source: Silver Lake Resources

Drilling Results at Magic

SLR has reported (on 30 July 2009) assay results from a 20 hole surface RC drilling programme at the Magic deposit, 3km south of the Daisy Milano mine. The drilling intersected near surface thick high grade mineralisation which continues at depth. The Magic deposit will be the next open pit production source following the recently commenced Christmas Flat Project.

The mining study is well advanced, metallurgical test work is underway and, providing results are as expected, mining at Magic could commence early in 2010.

Both the Christmas Flat and Magic Projects may also provide underground mining opportunities.

Mount Monger Resource Inventory

<u>Overall</u>, the drill results at the Magic deposit, along with the discovery of Daisy East, Emma and the extension of the Rosemary lode, support the company's view (and ours) of a potentially larger resource base at Mount Monger. Recent successes also strengthen the case for expanding the Lakewood Gold Processing Facility. **<u>The drilling provides us with greater confidence in assuming +500koz in resources/reserves in our base case valuation for SLR compared to the just reported 390koz in the June 2009 resource inventory</u> (3 August 2009).**

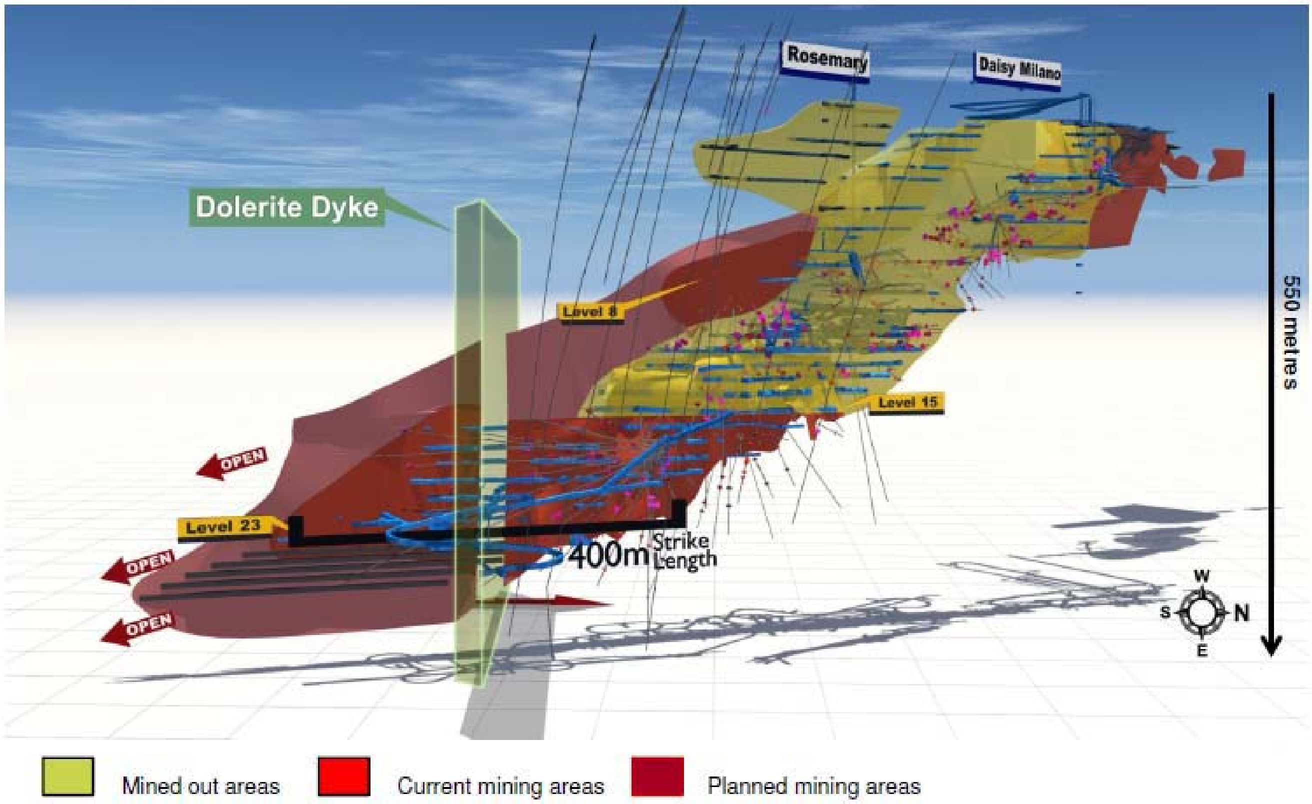
Potential future increases in estimated resources are likely to come from: deeper drilling at Daisy Milano south of the dolerite dyke; from estimates for Daisy East, Emma and the extension of the Rosemary lode; and from drilling of numerous targets along a 10km strike.

The next round of underground drilling planned later this year from the 26 level (500 vertical metres below the surface) will include deep holes down to 800 vertical metres to confirm the structural continuity of the Daisy Milano ore system. (The current geology model and mine plan has now been extrapolated to 600m below the surface.)

The June 2009 resource inventory reveals that:

- The in-situ (<u>undiluted</u>) average resource grade for Daisy Milano has increased 31% to 40.5g/t Au due to high grade zones encountered south of the dolerite dyke;
- 60% of the Daisy Milano resource is in measured status (45% previously).

Daisy Milano – Open at Depth & Along Strike



Source: Silver Lake Resources

June Quarter Report

Highlights from SLR's June Quarter had been reported on 6 July, including: June quarter gold sales of 15,111 oz at an average realised price of A$1,210/oz (full year gold sales of 48,353oz at A$1,200 oz); and cash and bullion on hand at 30 June 2009 of $20.0m (SLR has no debt or hedging); and cumulative cash flow from Daisy Milano has already paid back the acquisition costs for both the mine and the Lakewood mill.

June quarter mine production averaged 8.9 g/t Au which was lower than the March quarter (11.2g/t;) and the full year (10.0g/t) due to ~80% of production coming from lower grade mining areas north of the dolerite dyke. A 40,000oz high grade stoping panel is being set up predominately south of the dolerite dyke with production commencing in the September 2009 quarter.

Christmas Flat – Open pit production

The Christmas Flat Project located 1km north of Daisy Milano commenced in June 2009. Stage 1 of the open pit is predominately free dig and produces ~10koz at a total cash cost (including capital) of A$700/oz. Mining of Stage 1 is expected to be completed in 6 months and processing completed in 12 months as the company's Lakewood Gold Processing Facility (LGPF) will be running at capacity from the September 2009 quarter.

The remaining resource of 41koz at Christmas Flat may be extracted by either an open pit cutback or from underground.

Lakewood Gold Processing Facility (LGPF)

SLR plans to complete a Stage 1 expansion of the LGPF in January 2010 by the addition of two CIL tanks, a pre-leach thickener and an upgrade to cyclones (estimated capital cost: ~$4m). Upgraded mill capacity depends on the proportion of hard and soft ore **– we model throughput of just under 500ktpa for the 2011FY through to the 2014FY.** (Current mill capacity is 300kt of hard and soft ore or 180-220kt for hard ore feed only. The 300ktpa capacity is now fully utilised.)

A potential Stage 2 expansion will include a regrind mill, an additional gravity circuit, electrical upgrade and additional tailings storage (estimated capital cost: ~$4.5m). This expansion would take mill capacity to 600ktpa. A decision committing to the Stage 2 expansion is unlikely within the next 12 months.

Valuation

Our base case valuation, which now includes the Stage 1 expansion of the LGPF (an expansion was previously in our upside case), has increased to $0.90/share. It is based on a five year mine life at Mount Monger (assuming a resource/reserve base of 530koz) and using a 5% discount rate.

The discovery of Daisy East, Emma and the extension of the Rosemary lode (reported on 27 July 2009) in close proximity to the Daisy Milano infrastructure support the company's view (and ours) of a potentially larger resource base at Mount Monger, compared to the just reported 390koz in the June 2009 resource inventory (released 3 August 2009).

Our upside case ($1.09/share) includes a modest valuation for SLR's interest in the Murchison Goldfield, where the company continues to review low capital milling options for the project.

If we assumed the current spot gold price (US$965/oz) and $A/US rate (0.8445) for the 2010-14FY period, our base case valuation would increase to $1.03/share. For this sensitivity, estimated earnings for the 2011FY would be $29.6m (est P/E ratio: 4.3x at $0.705/share) and for 2012FY would be $32.2m (est P/E ratio: 3.9x at $0.705/share).

Valuation as at 30/6/09	A$m	NPV/share
Mount Monger Gold Mine [1]	133	0.74
Net Cash & Bullion	20	0.11
Capitalised corporate costs	-8	-0.04
Future value of option exercise	7	0.04
Exploration - Additional Value [2]	5	0.03
Lakewood Plant - Residual Value	5	0.03
Base Case Valuation	**162**	**0.90**
Murchison Goldfield	35	0.19
Upside Valuation	197	1.09

[1] Assumes 530koz of mineable reserves (total 5 year mine life)

[2] Additional discounted value of exploration expenditure - targeting +2Moz in resources at Mount Monger

Mount Monger GoldField		2008	2009	2010	2011
Daisy-Milano ore milled	mt	0.021	0.160	0.160	0.320
	g/tAu	10.2	9.7	10.0	10.0
Christmas Flats	mt		0.003	0.100	0.080
	g/tAu		2.0	3.5	3.5
Magic, Costello & Lorna Doone	mt			0.030	0.050
	g/tAu			4.0	2.9
Total Ore Milled	mt	0.021	0.160	0.290	0.450
Recovery		84.0%	95.0%	95.0%	95.0%
Gold Production	**koz**	**5.8**	**47.3**	**63.2**	**110.7**
Gold Price	$US/oz	890	896	933	850
	$A/oz	935	1200	1196	1118
Cash costs excl royalties	$A/oz	719	742	683	638
Cash costs incl royalties	$A/oz	**739**	**780**	**722**	**674**

Profit / (Loss) $Am	2008	2009	2010	2011
Revenue	2.9	58.0	75.6	123.8
Mining, Transport, Admin	-3.4	-28.7	-36.0	-59.4
Milling	-0.8	-6.4	-7.3	-11.3
Operating Surplus	-1.2	22.9	32.4	53.2
Royalties	-0.1	-1.8	-2.5	-4.0
Depreciation/amort	-0.8	-5.2	-6.1	-7.1
Other	-1.6	-2.3	-2.3	-2.3
Pre-tax profit	-3.7	13.6	21.4	39.7
Tax expense	0.0	-2.9	-5.8	-11.9
Adjusted Profit	**-3.7**	**10.7**	**15.6**	**27.8**

Cash Flow $Am	2008	2009	2010	2011
Operating Surplus	-1.2	22.9	32.4	53.2
Royalties	-0.1	-1.8	-2.5	-4.0
Capital Expenditure	-19.0	-4.2	-8.5	-3.0
Expl'n/Business Dev	-3.2	-5.0	-4.5	-4.9
WC changes, other	-1.6	3.2	-2.3	-2.3
Tax Paid	0.0	0.0	0.0	-2.4
Net Cash Flow	**-25.1**	**15.1**	**14.6**	**36.6**

Murchison Goldfield

The Company continues to review low capital milling options for the Murchison project. Ongoing exploration will focus on extending current resources that are constrained by limited drilling particularly below 100m depth. SLR's strategy is to delineate sufficient resources to sustain a 100kozpa operation.

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.

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

Mount Monger – Background

Silver Lake's Mount Monger Operation comprises the Daisy Milano underground mine and the Christmas Flat open pit located 50 km SE of Kalgoorlie.

Mount Monger has additional potential open pit production from the Magic deposit and subsequently from the Costello and Lorna Doone deposits. The recent discoveries of Daisy East, Emma and the extension of the Rosemary lode show potential as near term production sources.

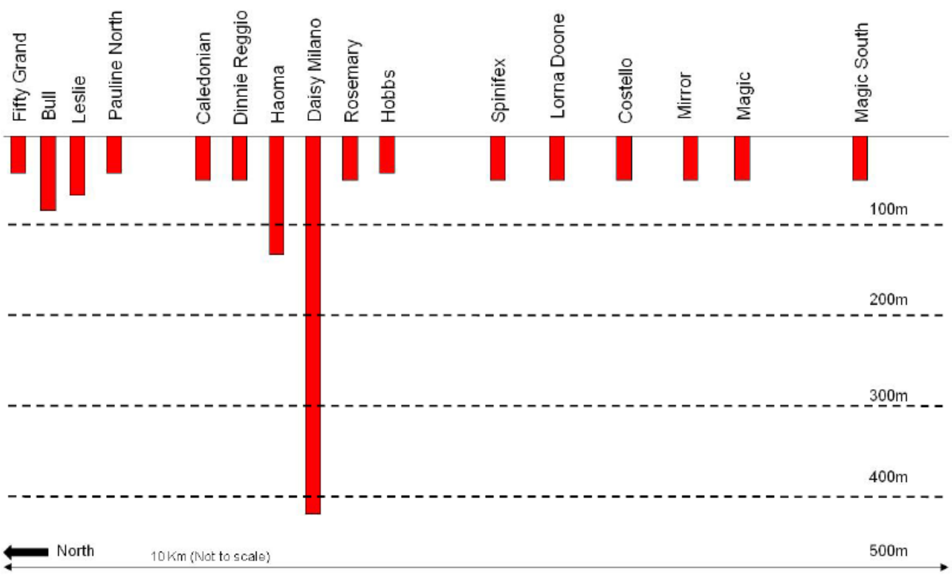
Gold ore from Mount Monger is transported to Silver Lake's 300ktpa LGPF located 5 km SE of Kalgoorlie and 45 km from the Daisy Milano mine.

Silver Lake poured the first gold at its LGPF in April 2008 after commencing operations at Daisy Milano in December 2007. SLR had acquired 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 has increasingly appeared highly favourable to SLR.

SLR separately purchased (30 November 2007) and refurbished the Lakewood Gold Processing Facility (cost: $2.4m; plus $4.6m included installation of a gravity circuit). The replacement cost would now be >$25m, plus extended delays for mill delivery.

Mount Monger Goldfield

Multi Mine Operation & Potential at Depth



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
Average	**23.7 g/t**

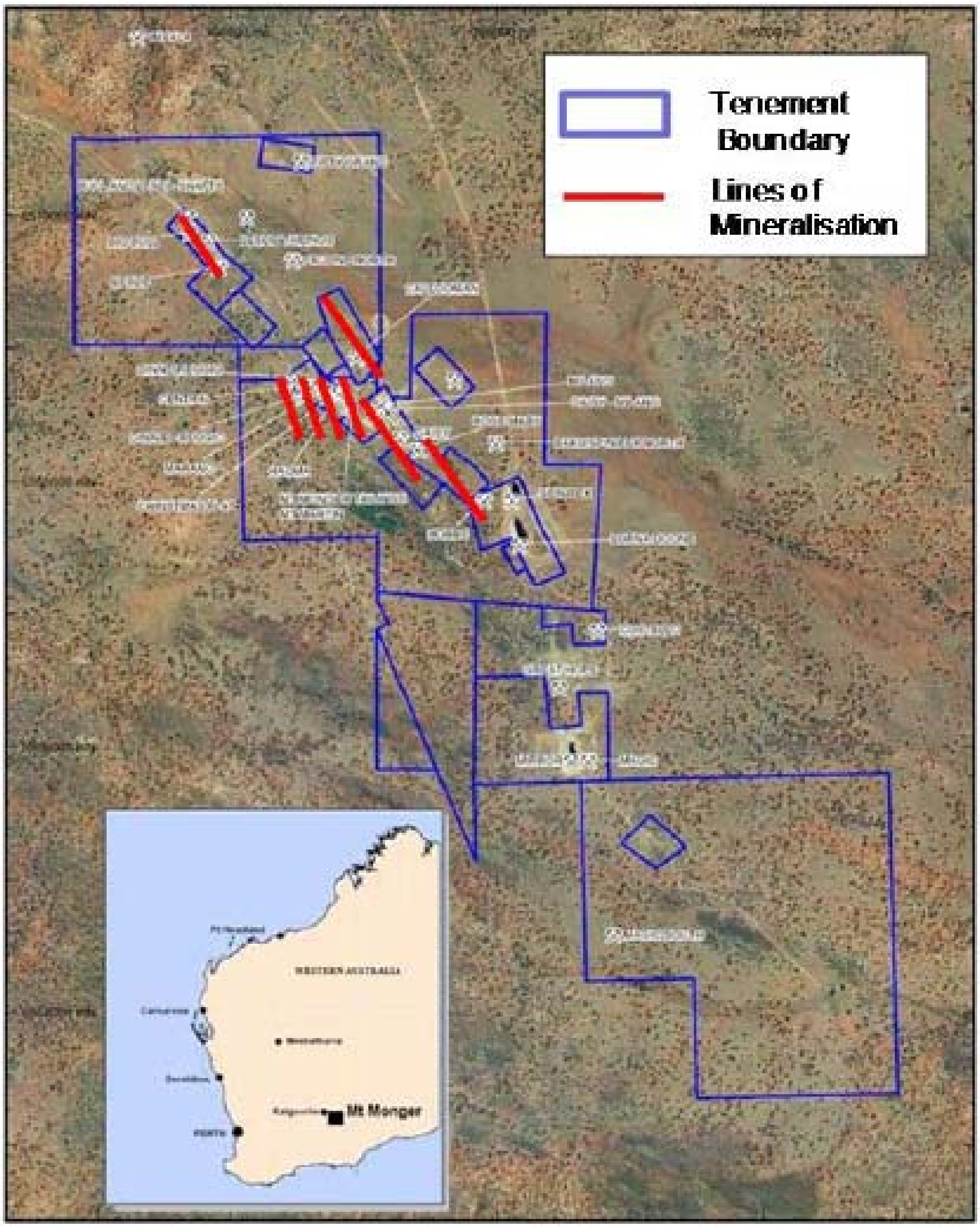
Source: Silver Lake Resources

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 2.0 to 4.5Moz.

SLR is targeting >2Moz in resources across the Mount Monger tenements. The total Mount Monger resource inventory at December 2008 was 1.2mt at 9.7 g/t Au for 374,900oz.

SLR's monthly mined grades at Daisy Milano have typically been 7-15g/t, based on selective mining with minimal dilution (up to 2m widths).

Silver Lake's Mount Monger Tenements



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