Silver Lake Resources (SLR)

Recommendation: Buy | 23 November 2009

Significant potential upside from exploration programmes

- SLR reported positive results in its Exploration Update (5 November 2009). The current $4m exploration programme at Mount Monger and the $18m accelerated exploration plan are targeting: a potential 2–4.5Moz of gold at Mount Monger; and a 3Moz potential at the Murchison Goldfield.
- Our valuation is contingent on SLR increasing its reserve base at Mount Monger to a minimum ~800koz. We view this as reasonable given recent exploration success – the potential resource upside at Mount Monger will be better defined within six months and is well above 800koz.
- Our base case valuation, which now includes the Stage 1 and Stage 2 expansions of the LGPF, has increased to $1.54/share on our assumptions (compared to $1.32/share, 2 October 2009). It is based on a five year mine life at Mount Monger (at expanded production rates) and using a 5% discount rate. Our valuation falls slightly to $1.49/share if we assume a constant spot gold price (US$900/oz) and $A/US rate (0.80) for the 2010-14FY period.
- Using a 10% discount rate reduces our valuation from $1.54/share to $1.37/share.
- If we used the current gold forward curve as at 20 November 2009 (US$1,137/oz in 2010 rising to US$1,223/oz in 2013) and forward $A/US rates (~0.89 for 2010; 0.76 in 5 years), our valuation would increase to $2.35/share.
- Our upside case ($1.71/share) retains only a modest valuation for SLR's interest in the Murchison Goldfield. Whilst the accelerated exploration plan is targeting significantly increased resources in the Murchison, in our view, the market is assigning zero value for SLR's Murchison assets.
- At $1.045/share, we retain a Buy recommendation for SLR. The stock should be viewed as relatively high risk, given all the usual risks attached to narrow vein underground mining and realised gold prices (SLR has no hedging). The company has a very capable Board (ex-WMC) and management.

Share price:	$1.045
52 week price range:	$0.15/$1.08
Market capitalisation ($m):	186

Year ending 30 June	2008 Act	2009 Act	2010 Est	2011 Est	2012 Est
Adjusted Profit	-3.6	10.7	4.5	30.0	57.8
EPS (fully diluted) (cps)	-3.4	6.9	2.3	14.7	28.5
P/E ratio (x)	na	15.1	46.1	7.1	3.7
DPS (c)	0.0	0.0	0.0	3.0	3.0
Yield (%)	0.0%	0.0%	0.0%	2.9%	2.9%
Assumptions					
Gold production (koz)	6	47	63	110	137
$A/US	0.950	0.746	0.900	0.900	0.820
Gold (US$/oz)	890	896	1013	1035	970

Analyst: Rob Craigie

Mount Monger Operations Summary		2009 Act	2010 Est	2011 Est	2012 Est	2013 Est
Daisy-Milano	mt	0.160	0.190	0.300	0.400	0.400
	g/t Au	9.7	9.2	10.0	10.0	10.0
Open Pits - Christmas Flats, Magic	mt	0.003	0.080	0.200	0.000	0.000
	g/t Au	0.0	3.8	3.0	0.0	0.0
U'ground - Christmas Flats, Magic	mt			0.000	0.100	0.200
	g/t Au			0.0	5.0	5.0
Total Ore **Milled**	mt	0.160	0.270	0.500	0.500	0.600
Recovery		95%	95%	95%	95%	95%
Gold Production	**koz**	**47.3**	**62.6**	**110.0**	**137.4**	**152.7**
$A/US		0.746	0.900	0.900	0.820	0.790
Gold Price	$US/oz	896	1013	1035	970	900
	$A/oz	1200	1125	1150	1183	1139
Cash operating costs	$A/oz	647	724	524	405	404
Cash costs incl mine development	$A/oz	742	834	619	455	449
Total cash costs incl mine development & royalties	**$A/oz**	**780**	**870**	**656**	**493**	**485**
Total costs incl royalties	$A/oz	892	944	713	544	538

Summary Profit / (Loss) - Year end 30 June		2009 Act	2010 Est	2011 Est	2012 Est	2013 Est
Revenue	A$m	58.0	70.4	126.5	162.6	174.0
Ore Mining		-22.6	-30.8	-41.3	-39.3	-43.3
Mine Development expensed		-4.5	-6.9	-10.4	-6.9	-6.9
Transport to LGPF		-0.3	-2.1	-3.9	-3.9	-4.7
Milling		-7.4	-11.9	-12.0	-12.0	-13.2
Site Administration		-0.4	-0.5	-0.5	-0.5	-0.5
Operating Surplus		22.9	18.2	58.4	100.1	105.5
Royalties		-1.9	-2.3	-4.0	-5.2	-5.6
Depreciation/Amort		-5.2	-4.6	-6.4	-7.0	-8.0
Exploration/evaluation expensed		0.0	-3.0	-3.0	-3.0	-3.0
Corporate / Other		-2.2	-2.2	-2.2	-2.2	-2.2
Pre-tax profit		13.6	6.1	42.8	82.6	86.7
Tax expense		-2.9	-1.7	-12.8	-24.8	-26.0
Adjusted Profit		**10.7**	**4.5**	**30.0**	**57.8**	**60.7**

Summary Cash Flow - Year ending 30 June		2009 Act	2010 Est	2011 Est	2012 Est	2013 Est
Operating Surplus	A$m	22.9	18.2	58.4	100.1	105.5
Royalties		-1.9	-2.3	-4.0	-5.2	-5.6
Capital Expenditure		-4.2	-6.0	-7.0	-2.0	-2.0
Exploration/Business Development [1]		-5.0	-6.7	-8.1	-4.0	-4.0
WC changes, Other		3.3	-2.2	-2.2	-2.2	-2.2
Tax Paid		0.0	0.0	0.0	-13.3	-25.5
Cash Flow before funding		**15.1**	**1.1**	**37.1**	**73.4**	**66.2**

Current/Accelerated Exploration Plans

SLR reported positive results in its Exploration Update (released on 5 November 2009).

The current $4m exploration programme at Mount Monger and the $18m accelerated exploration plan (following the $18m capital raising) **are <u>targeting:</u>**

- **A potential 2–4.5Moz of gold at Mount Monger**; and
- **A 3Moz potential at the Murchison Goldfield** (total indicated and inferred resources for the Murchison are currently 0.965Moz of gold).

<u>Mount Monger – Exploration Plan</u>

Daisy Deeps
Daisy Deeps is the area within the Daisy Milano mineralised system below 500 vertical metres from the surface. The underground drilling programme is designed to firm up the mineralisation down to 800 vertical metres below the surface which could significantly increase the resource and projected mine life.

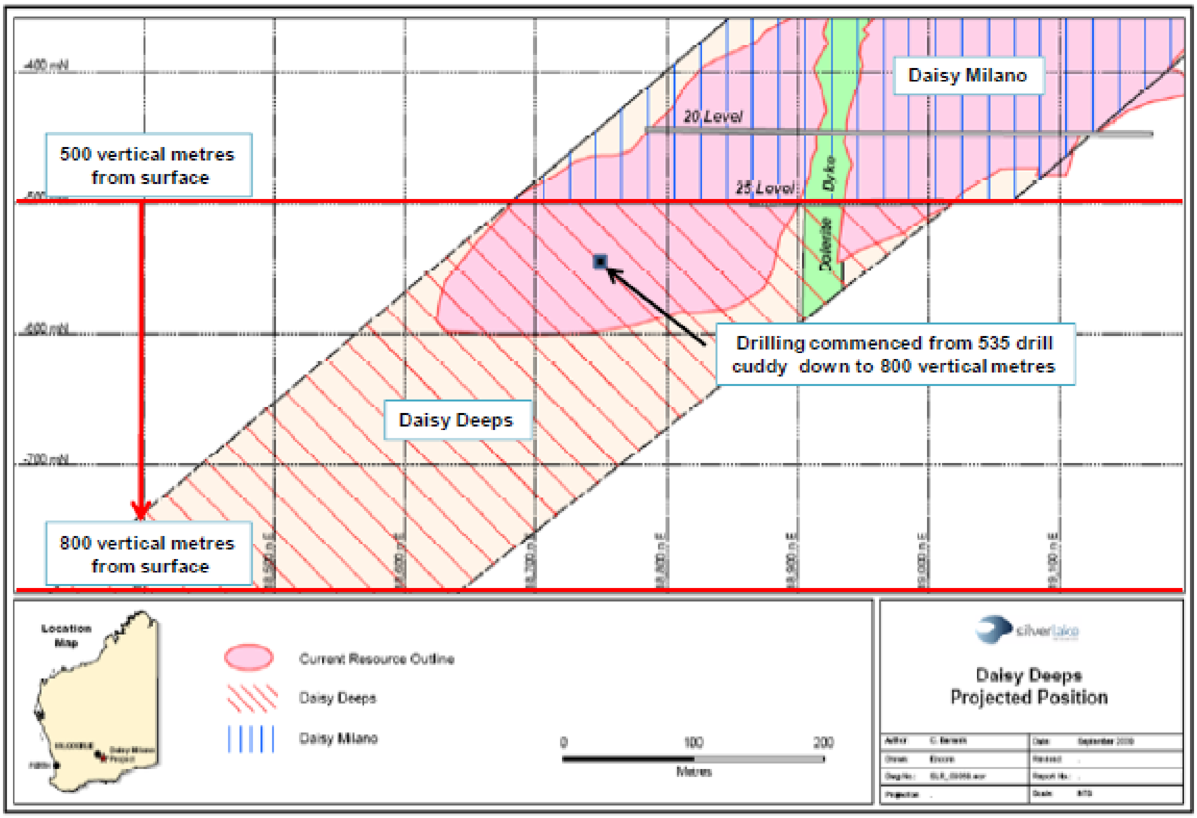
Encouraging results have been returned from an initial 17 holes all containing multiple high grade intercepts with varying grades and widths typically seen in the Daisy Milano mineralised system. Development has been completed to an optimal drilling position and drilling has commenced down to the 800 vertical metre horizon (refer to Figure 1).

Daisy East, Emma and Rosemary Extension
In addition to Daisy Deeps drilling, underground drilling programmes are targeting the recent discoveries of Daisy East, Emma and Rosemary extension.

The structures contain typical Daisy Milano style narrow vein mineralisation with sericite pyrite alteration and with some intercepts containing visible gold.

As at 5 November 2009, forty diamond drill holes have been completed from the Daisy Milano 8 level targeting the new discoveries of Daisy East, Emma and Rosemary extension that are located 40 metres, 70 metres and 120 metres respectively to the east of Daisy Milano (refer to Figure 2).

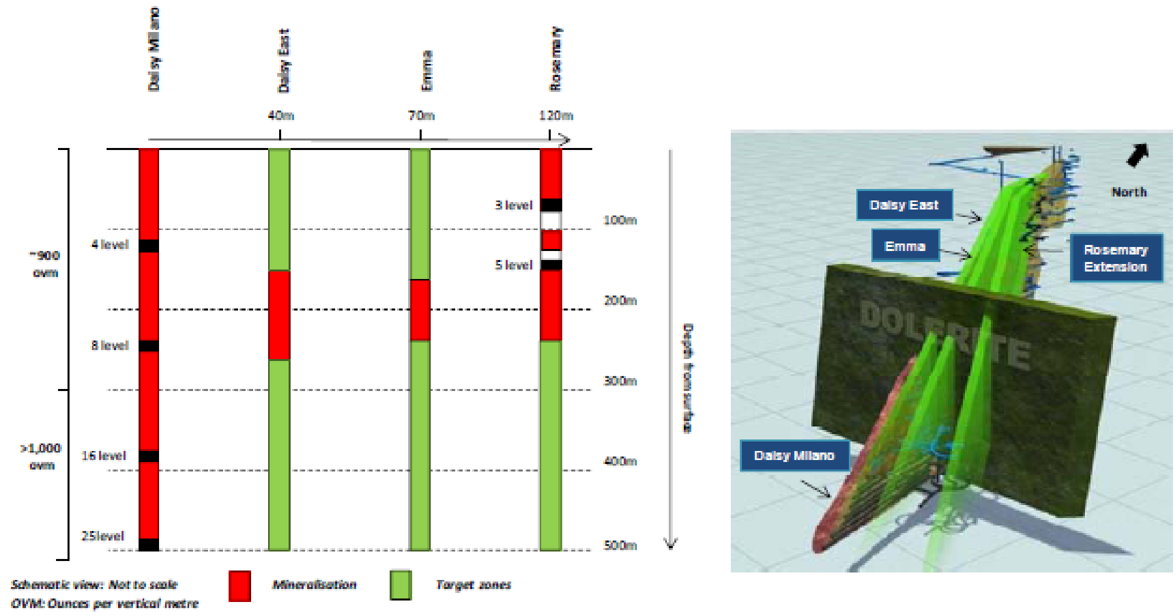
Figure 1 - Long Section showing Daisy Deeps projected position



Source: Silver Lake Resources

Figure 2 - Schematic view of Daisy Milano, Daisy East, Emma, Rosemary Extension

Green areas are target zones.



Source: Silver Lake Resources

Drilling to date at Daisy East has increased the defined mineralised structure from 40 vertical metres to ~100 vertical metres and is open along strike and up and down dip.

Approximately **110 metres of ore development has been completed on the Daisy East structure which continues to yield mined grades of ~10 g/t gold**.

Daisy Milano is currently endowed with >1,000 ounces per vertical metre. **Assuming Daisy East, Emma and Rosemary Extension have just 300 ounces per vertical metre by mid 2010 would increase the Mount Monger resource base to 1.2Moz.**

Surface drilling targets

Surface drilling programmes are targeting the Leslie high grade zone and depth extensions of the Magic, Christmas Flat and Lorna Doone deposits (refer to Figure 5 for location plan). In addition the exploration programme is targeting three independent zones at Mount Monger; Big Bull to Dinnie Reggio, Fifty Grand to Caledonian and Lucky Strike to Lorna Doone.

The exploration plan comprises a total of 55,000m of RC and diamond drilling (50-450m deep holes) over the next two years.

Mount Monger Resource Inventory

Recent drilling results now provide us with some confidence in assuming a minimum 800koz in reserves at Mount Monger (with a reasonable resources/reserves conversion) in our base case valuation for SLR - compared to the just reported 390koz in the June 2009 resource inventory (3 August 2009).

We anticipate that the potential resource upside at Mount Monger will be better defined within six months. This will be most important in terms of underpinning our valuations of SLR.

Murchison - Exploration Plan

The recently announced accelerated exploration plan is targeting to significantly increase resources at the Tuckabianna, Comet and Moyagee projects (refer to Figure 4) located in the Murchison Goldfields which currently have a combined resource of 7.8mt at 3.8g/t (965koz). The exploration plan comprises a total of 60,000m of RC and diamond drilling (50-450m deep holes).

In our view, the market is assigning zero value for SLR's assets in the Murchison. We note Silver Lake is describing **the Lena project** at Moyagee (current inferred resources: 820koz at 8.5g/t gold or 224koz contained gold) in the Murchison **as "a world class exploration project"**. **Whilst this may be arguable at this stage,** SLR's Exploration Update

(5 November 2009) has indicated that the initial six diamond holes drilled 100m north of the current resource have all intersected the mineralised zone. Sericite, quartz and pyrite alteration is consistent with the current resource. Visible gold is present in some of the drill core – assays are pending. Watch this space!

The next phase of the programme will be to the south of the Lena resource and consists of 52 surface drill holes some of which are targeting significant intersections 4km along strike and south of Lena.

September Quarter Report

Mill feed consisted of a blend of Daisy Milano high grade, Daisy Milano low grade and Christmas Flat ores producing 12,152oz (June quarter: 14,289oz). Mined grade from Daisy Milano averaged 8.0 g/t gold primarily due to single access stope sequencing.

Importantly, however, the high grade zone on the 24 level intersected mid September was 30m further south than the 23 level (at end October) and outside the current resource boundary. This is positive for high grade resource/reserve additions (but delays retreat stoping). Refer to Figure 3.

Additionally, low grade stocks were milled for 10 days during the quarter due to seasonal weather interrupting higher grade ore supply from Daisy Milano to the Lakewood Gold Processing Facility.

Revenue of $12.7m for the quarter was lower than expected with only 11,049oz of refined gold sold at an average realised price of $1,152/oz. Bullion refined and not sold at the end of the quarter totalled 1,960 ounces. Operating cash flow totalled $2.9m after allowing $1.6m for pre-strip and start up production costs at Christmas Flat. Cash and bullion on hand totalled $18.6m at 30 September 2009 (prior to receiving funds from the $18.3m placement).

Christmas Flat - Open pit production

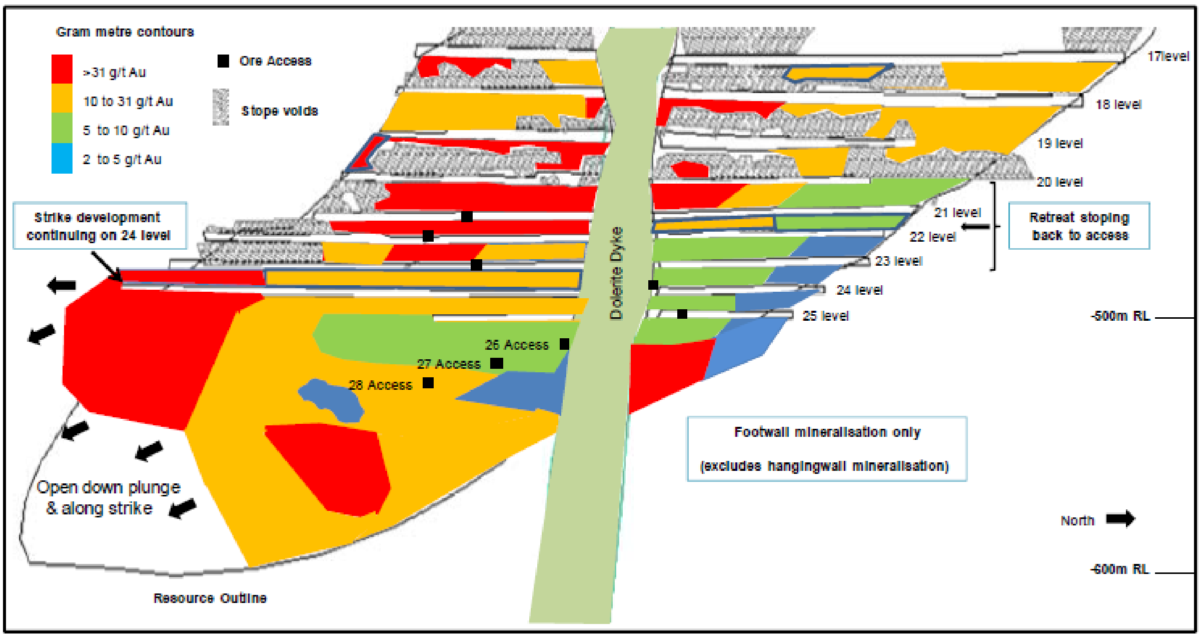
The Christmas Flat Project located 1km north of Daisy Milano commenced in June 2009. Stage 1 of the open pit is predominately free dig and produces ~10koz at a total cash cost (including capital) of A$700/oz.

The remaining resource of 41,000 oz at Christmas Flat is being evaluated to be extracted by either an open pit cutback or from underground.

Unit Costs

Cash operating costs (all direct mining, road transport and processing costs) for the quarter were A$746/oz. This was negatively impacted by the operating costs associated with initial start up production of 673oz from Christmas Flat open pit. This has a positive impact on cash operating costs going forward as ore production from Christmas Flat is forecast to be 4,000 oz in December 2009 quarter with another 5,500 ounces produced in January 2010.

Figure 3 - Schematic view of Daisy Milano (below 17 level) indicating gram metre contours



Source: Silver Lake Resources

Waste development costs for the quarter were $342/oz which includes costs associated with 420kt of waste material removed from Christmas Flat open pit. As the project is being completed in less than 12 months all costs associated with waste and ore removal are being expensed and not capitalised. Total cash costs (including royalties) for the quarter were A$1,123/oz.

None of the unit costs for the quarter are representative of ongoing operations. September 2009 quarter unit costs are higher primarily due to the costs associated with Christmas Flat open pit over initial start up ore production of 673 ounces. 45% of the project mining costs have been expensed for 7% of project ounces.

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).

Upon completion of the Stage 1 upgrade, the facility will be capable of processing 400ktpa of hard rock and up to 600ktpa of blended rock. (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 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.

SLR's 2010FY Objectives

- Continue production of ~50koz gold from Daisy Milano and **extend mine life beyond five years;**
- Complete mining stage 1 Christmas Flat for 10koz gold;
- Commence production from the **Magic open pit;**
- **Expand the Lakewood Gold Processing Facility to 600ktpa;**
- Complete mining studies for **Christmas Flat stage 2, Costello and Lorna Doone open pits;**
- Continue to grow the resource base at Mount Monger;
- Delineate further resources at the **Murchison projects** to sustain a high margin operation; and
- Maintain a strong balance sheet.

Valuation

Our valuation is contingent on SLR increasing its reserve base at Mount Monger to a minimum ~800koz. We view this as reasonable given recent exploration success – as we have noted earlier, the potential resource upside at Mount Monger will be better defined within six months and is well above 800koz.

Our base case valuation, which now includes the Stage 1 and Stage 2 expansions of the LGPF, has increased to $1.54/share on our assumptions. It is based on a five year mine life at Mount Monger (at expanded production rates) and using a 5% discount rate. Our valuation falls slightly to $1.49/share if we assume a constant spot gold price (US$900/oz) and $A/US rate (0.80) for the 2010-14FY period.

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Our upside case ($1.71/share) retains a modest valuation for SLR's interest in the Murchison Goldfield.

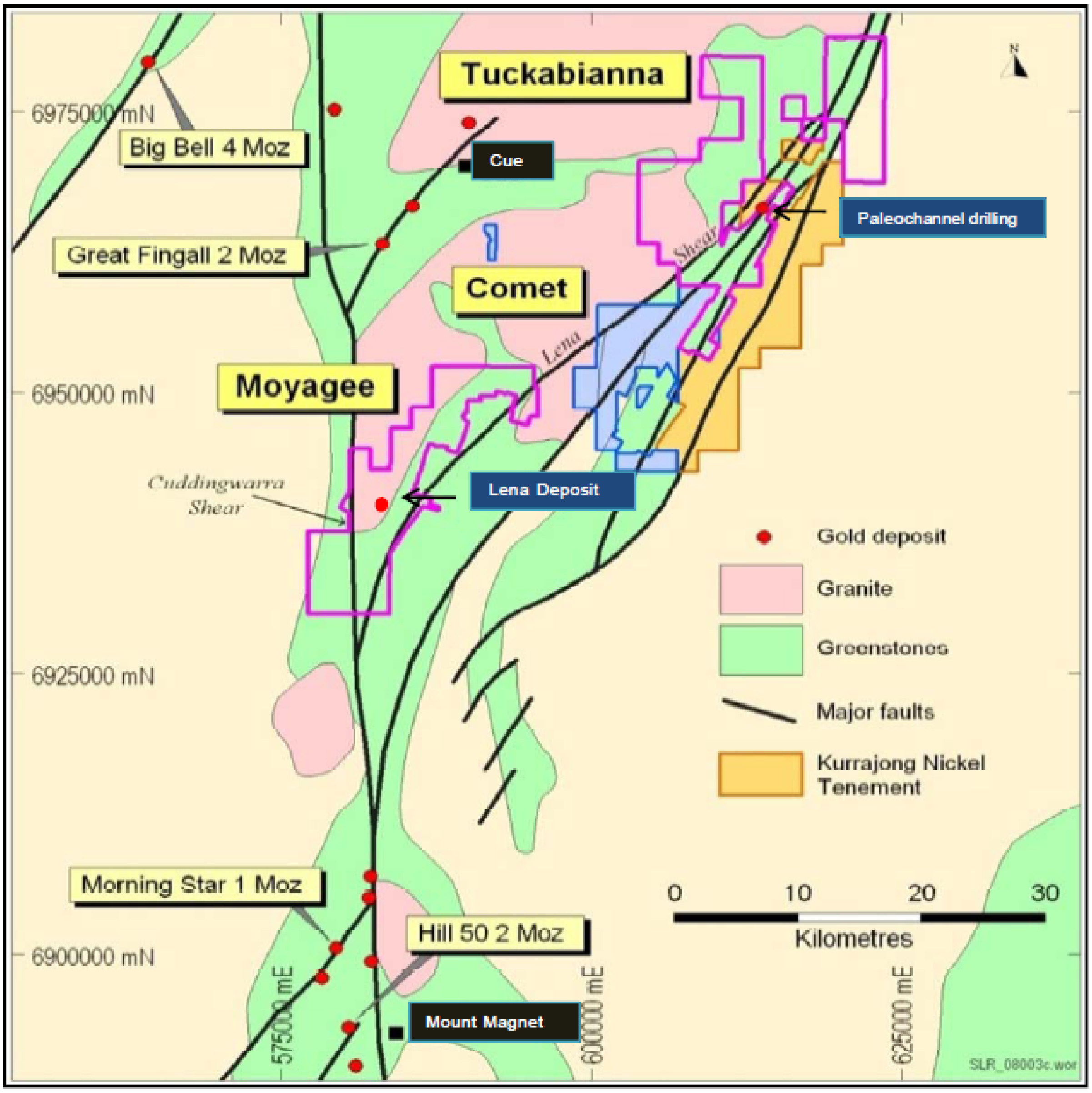
Base Case Valuation [1]	A$m	NPV/share
Mount Monger Gold Mine [2]	277	1.36
Net Cash & Bullion	37	0.18
Capitalised corporate costs	-8	-0.04
Future value of option exercise	7	0.04
Base Case Valuation	**313**	**1.54**
Murchison Goldfield	35	0.17
Upside Valuation	348	1.71

1 Cash includes $18.3m from capital raising completed in October 2009.
Based on 178.1m fully paid ordinary shares (includes 23.9m unlisted, restricted shares).
2 Assumes Lakewood Plant Expansion and reserves for 5 year mine life.

Murchison Goldfield

The Company continues to review low capital milling options for the Murchison project. SLR's strategy is to delineate sufficient resources through the accelerated exploration programme to sustain gold operations producing 150kozpa.

Figure 4 – Murchison Goldfield – Location Plan



Source: Silver Lake Resources

The Murchison Goldfield includes the Tuckabianna, Comet, Moyage and Rothsay deposits (refer to Figure 4).

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 material potential as near term production sources.

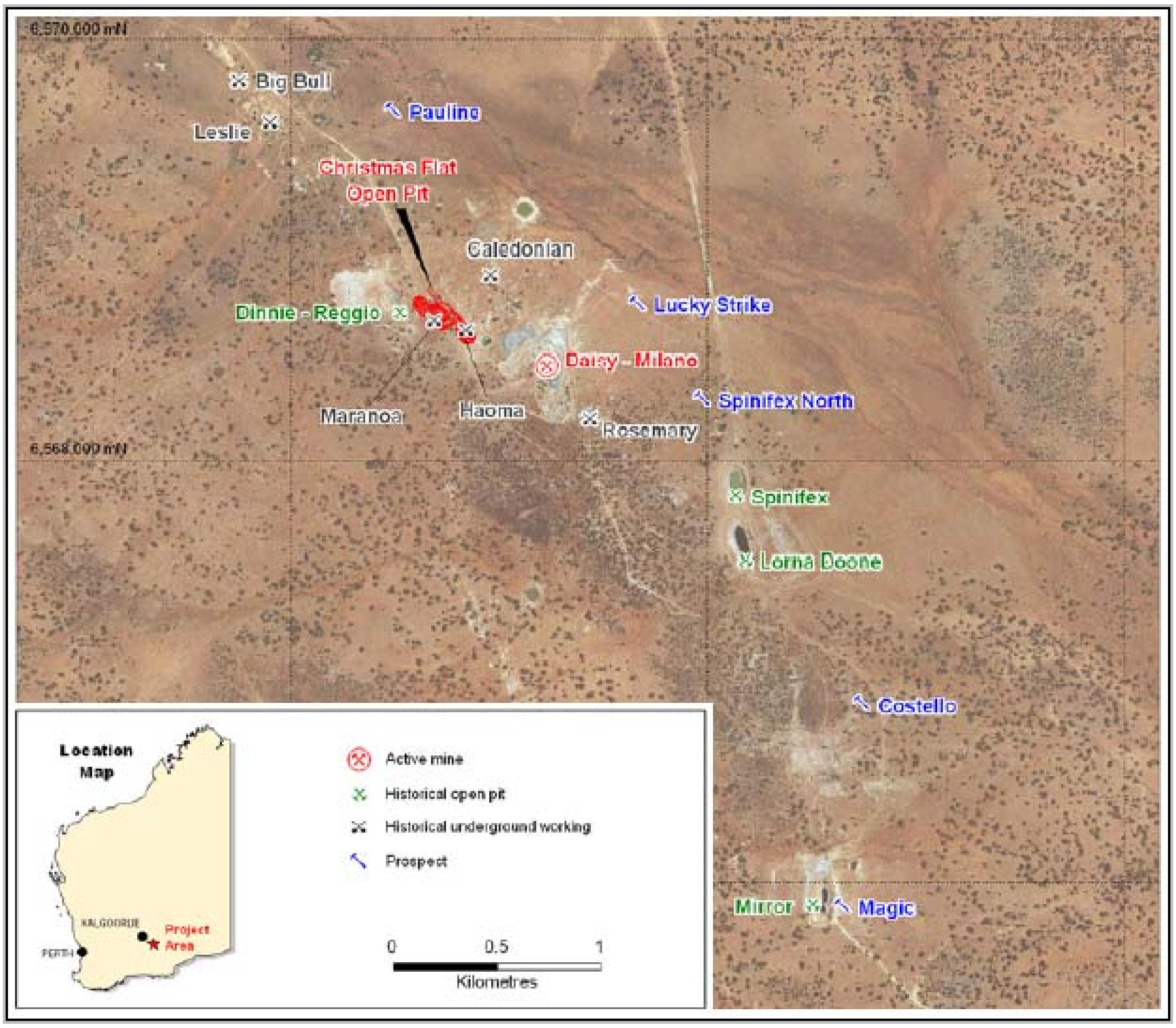
Gold ore from Mount Monger is transported to Silver Lake's LGPF located 5km SE of Kalgoorlie and 45km from the Daisy Milano mine.

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 had 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.

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.

Figure 5 – Silver Lake's Mount Monger Project – Location Plan



Source: Silver Lake Resources

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