

Silver Lake Resources (SLR)

Recommendation: Accumulate

21 September 2011

On target to increase total gold resources to 4–5Moz by June 2012

Key Points

The company's gold production targets for the Mount Monger Operations are 100–110koz in the 2012FY (skewed to the June half) and 150koz in 2013FY. SLR is targeting combined gold-in-ore production of 300koz in the 2014FY from Mount Monger and a potential Murchison gold operation (with a development decision late this year and first production in the second half of the 2013FY).

Exploration continues to deliver highly encouraging results at Mount Monger (especially at Haoma) and in the Murchison (eg deeper drilling at the Caustons deposit; initial drilling of copper targets at the Eelya Complex). SLR is on target to increase its total gold resources to 4–5Moz by June 2012.

Earnings are sensitive to prospective gold price movements. A 10% increase in our average gold

price assumptions for the 2012FY, 2013FY and the 2014FY would increase our estimated earnings by 23–25% in these years.

Recommendation

At \$2.76 per share, we retain an Accumulate recommendation. Gold equities still generally lag the upward move in the spot gold price.

Our base case valuation for SLR is \$3.01/share, which increases by \$0.82/share for every 10% rise in our average gold price assumptions.

If we used the current gold forward curve and forward \$A/US rates as at 20 September, our valuation would increase to \$6.01/share – double our base case valuation.

SLR's Board and management continue to build a demonstrably good track record.

Share price:	\$2.76
52 week price range:	\$1.57/\$2.85
Market capitalisation (\$m):	493

Year ending 30 June	2010	2011	2012	2013	2014
	Act	Act	Est	Est	Est
Adjusted Profit ¹	11.8	15.8	51.4	70.6	105.4
EPS (fully diluted) ¹ (cps)	6.2	7.9	25.3	34.8	51.9
P/E ratio (x)	44.3	34.9	10.9	7.9	5.3
DPS (c)	0.0	0.0	0.0	5.0	10.0
Franking (%)	0	0	0	100	100
Yield (%)	0.0%	0.0%	0.0%	1.8%	3.6%
Assumptions					
Gold production ¹ (koz)	60	63	104	164	228
\$A/US	0.881	0.991	1.045	0.980	0.885
Gold price (US\$/oz)	1105	1390	1723	1500	1325

¹ Includes production starting from a potential Murchison Gold Operation in the second half of the 2013FY.

Analyst: Rob Craigie

Operations Summary		2010	2011	2012	2013	2014
		Act	Act	Est	Est	Est
Mount Monger						
Underground ore mined	mt	0.225	0.300	0.400	0.530	0.600
	g/t Au	8.4	7.2	7.5	7.3	7.3
Open pit ore mined	mt	0.115	0.200	0.200	0.200	0.200
	g/t Au	2.4	2.8	3.5	3.5	3.5
Total Ore Hoisted	mt	0.340	0.406	0.520	0.780	0.850
Recovery		95%	95%	95%	95%	95%
Gold in ore hoisted	koz	69.5	77.3	109.6	148.5	164.9
Gold Production	koz	60.1	63.4	104.1	141.1	156.7
Gold Sales	koz	55.0	64.7	102.1	141.1	156.7
Cash operating costs	\$/oz	597	643	601	597	574
Cash costs incl life of mine development ¹	\$/oz	825	785	705	688	656
Cash costs as above + Royalties	\$/oz	864	834	757	737	704
Murchison						
Underground ore mined	mt					0.3
	g/t Au					3.5
Open pit ore mined	mt				0.3	0.5
	g/t Au				2.6	2.6
Total Ore Hoisted	mt				0.3	0.8
Recovery					93%	95%
Gold Production	koz				23.3	71.8
Gold Sales	koz				20.3	71.8
Cash operating costs	\$/oz				658	688
Total Group Gold Sales	koz	55.0	64.7	102.1	161.4	228.5
\$/US		0.881	0.991	1.045	0.980	0.885
Gold Price	z	1105	1390	1723	1500	1325
	\$/oz	1254	1391	1648	1531	1497

Summary Profit / (Loss) – Year end 30 June		2010	2011	2012	2013	2014
		Act	Act	Est	Est	Est
Revenue	A\$m	69.1	90.0	168.3	247.0	342.1
Operating Costs		-40.3	-49.6	-73.4	-116.6	-159.8
Mine Operating Surplus		28.8	40.4	94.9	130.5	182.3
Royalties		-2.2	-2.9	-5.4	-7.7	-10.2
Depreciation & Amortization		-7.6	-11.1	-11.9	-18.8	-21.3
Exploration & evaluation expense		-0.1	-0.8	0.0	0.0	0.0
Corporate & Other		-2.8	-3.6	-3.7	-3.8	-3.9
EBIT		16.1	22.0	73.9	100.2	146.8
Net Interest Revenue/(Expense)		0.6	0.8	0.8	1.7	3.8
Pre-tax profit		16.7	22.8	74.7	101.8	150.6
Tax expense		-4.9	-7.0	-23.3	-31.2	-45.2
Adjusted Profit		11.8	15.8	51.4	70.6	105.4

¹ Cash costs include life of mine waste development costs (SLR's "Total Cost - Sustainable").

Refer to page 7 for Estimated Cash Flow before Funding and Dividends

Background on Silver Lake

SLR's Mount Monger gold operation contains the Daisy Milano, Daisy East, Rosemary & Haoma underground mines and is located 50 km SE of Kalgoorlie. Mount Monger has additional multi-mine potential underpinned by emerging open pit production from the Wombola Dam, Wombola Pit and Magic deposits. Gold ore from Mount Monger is transported to SLR's Lakewood Gold Processing Facility located 5km SE of Kalgoorlie and 45km from the Daisy Milano mine.

Elsewhere in WA, the company's strategy in the Murchison is to develop a second mining operation with multiple mines feeding a central processing facility.



Production Outlook

The company's full year mine production guidance for the Mount Monger Operations for the 2012FY is 115-130koz of gold in ore from underground and open pit sources.

The Lakewood Gold Processing Facility is currently operating at maximum hard rock capacity of 400ktpa and is being expanded to 700ktpa hard rock capacity by the end of December 2011 (cost: A\$7-8m). A nine day shutdown is required in December 2011 to tie in the upgraded circuit. A second stage expansion to a capacity of 1.0mtpa for blended ore feed is due for completion in the September quarter 2012 (cost: A\$4-5m).

As the mill is constrained in the first half of the 2012FY, SLR expects gold produced and sold will be 35-40koz, rising to 65-70koz of gold in the second half. The full year guidance for gold production and sales for the 2011FY is 100-110koz of gold.

SLR is targeting gold production from Mount Monger of 150koz in the 2013FY. Our gold production estimate is 141koz.

In the Murchison, SLR is aiming for an initial 50koz of gold in ore production in the 2013FY. The company's conceptual total gold in ore production target for the 2013FY is around 200koz. **Based on a potential full year contribution of 100koz from the Murchison in the 2014FY, the company's conceptual total gold in ore production target is around 300koz.**

Valuation

Our base case valuation for SLR is \$3.01/share. Our valuation assumes a mine life at Mount Monger to the 2018FY and a Murchison gold operation with an eight year mine life and gold sales starting in the June half 2013.

We use a 5% real discount rate for future cash flows (a rate commonly used for gold stocks). At a 10% real discount rate, our base case valuation would reduce to \$2.46/share.

At 30 June 2011, SLR had cash and cash equivalents of \$23.4m, comprising \$18.5m in cash and \$4.9m in bullion on hand. The company has no debt or hedging.

Base Case Valuation ¹	A\$m	NPV/share
Mount Monger Gold Mine ²	403	1.99
Net Cash	19	0.09
Capitalised corporate costs	-25	-0.12
Future value of option exercise	7	0.03
Valuation excl Murchison	403	1.99
Murchison Gold Operation ³	208	1.02
Base Case Valuation	611	3.01

1. Based on 178.8m ordinary shares and 24.4m options.
2. Based on mine life to end of 2018FY.
3. The Murchison valuation is unrisks, even though SLR has not yet committed to the investment.

Our valuation increases by \$0.82/share for every 10% rise in average gold price assumptions over the projected mine lives.

If we used the current gold forward curve and forward \$A/US rates as at 20 September, our valuation would increase to \$6.01/share – double our base case valuation (based on forward prices of US\$1,785/oz for the 2012CY, rising steadily to US\$1,858/oz for the 2015CY).

Earnings Outlook

SLR reported an after tax profit of \$15.8m for the 2011FY, based on sales of 64koz of gold at an average realised price of A\$1,390oz.

We did not expect SLR to declare a dividend for the 2011FY. We expect dividends from the 2013FY following completion of the initial capital expenditure on establishing the Murchison Gold Operation and, to a much lesser extent, finalising expansion of the Lakewood Gold Processing Facility.

As production increases, we estimate earnings will rise by: 226% in the 2012FY, 37% in the 2013FY and 49% in the 2014FY on our base case assumptions.

Earnings are sensitive to prospective gold price movements. A 10% increase in our average gold price assumptions for the 2012FY, 2013FY and the 2014FY would increase our estimated earnings by 23-25% in these years (refer to the table below).

Est. Earnings (\$m)	2012	2013	2014
Base case	51.4	70.6	105.4
Gold price +10%	63.1	88.2	130.1

Mount Monger Gold Operation

The ongoing expansion of the Mount Monger Operations has been progressing well:

- A 520 metre deep ventilation shaft was completed on time and on budget (cost: \$5.1m) in the June quarter;
- The underground operations have been debottlenecked with production now from four underground mines;

- Ore development has commenced at Haoma;
- The staged, low capital cost upgrade of the Lakewood Gold Processing Facility is on schedule and budget;
- Significant drill intercepts have been reported between Daisy Deeps and Haoma; and
- Initial open pit production at Wombola Dam has now commenced and will be followed by a similar starter pit at Wombola Pit.

SLR's strategy is to target production of 200kozpa from Mount Monger by 2014 from:

- Three underground mines each producing up to 60kozpa; and
- The balance sourced from open-cut production.

Daisy Milano

Access development to the 32 & 33 levels commenced late in the June quarter and decline development was 30 metres below the 33 level.

The 520 metre deep ventilation shaft was completed during the June quarter on time and on budget. As a result the mining capacity of the underground operations increases from 250ktpa to 400ktpa. It has already enabled mining to commence from four underground mines.

Figure 1 - Mount Monger Location Plan

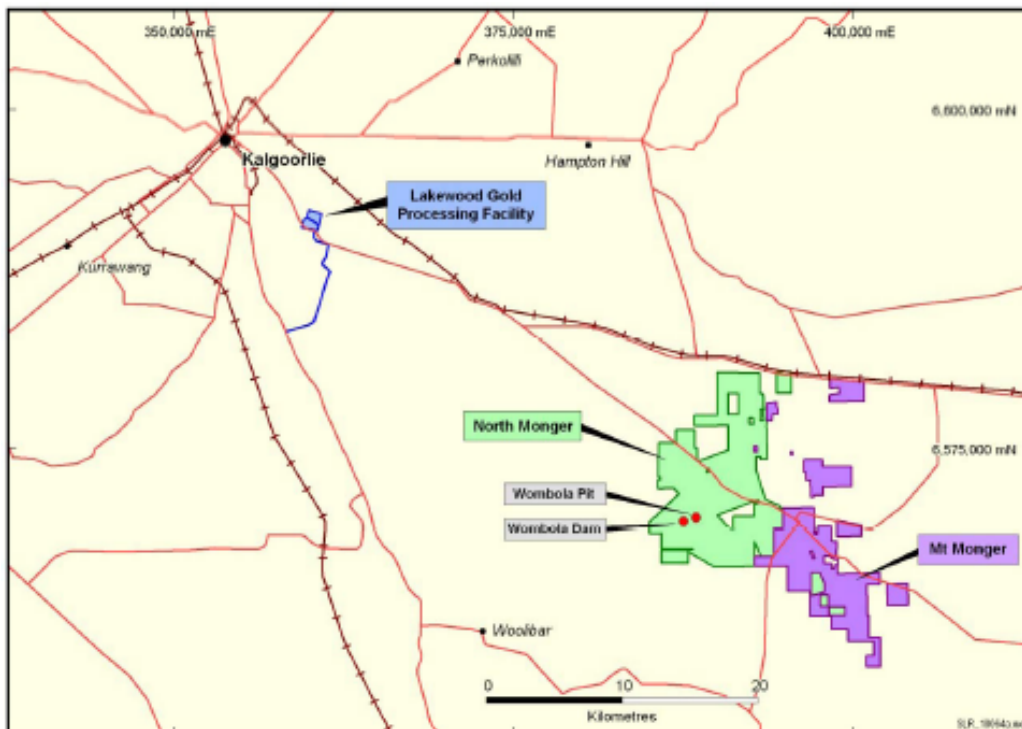
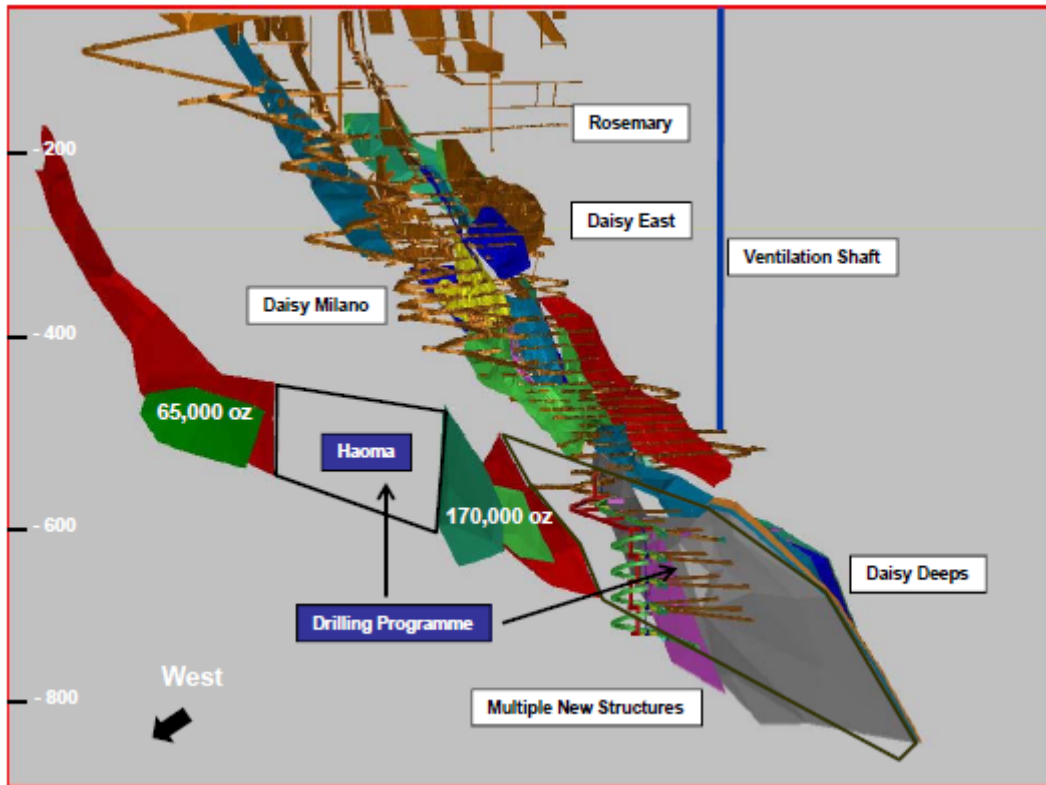


Figure 2 – Mount Monger Schematic View of Haoma, Daisy Deeps



Daisy East

All waste access development has been completed and ~100koz are now available for stoping over the next two years.

Haoma

Drilling and development to date indicates that the ore thickness at Haoma is greater than at Daisy Milano.

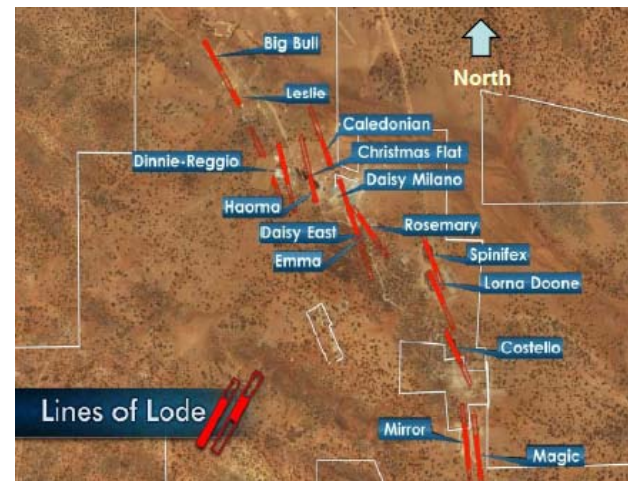
Initial ore development and production commenced during the June quarter at the Haoma 32 level. By mid July, over 70 metres of ore development had been completed and diluted mined grades in the 32 level north face continued to be greater than one ounce/tonne (>31g/t). More recently, SLR has advised that high grades have persisted over a drive length of 170m. This is highly encouraging. At this stage, the development is on only one level, so further drilling and development is needed to assess prospective ounces per vertical metre.

Several drill holes intersected mineralisation between 30 and 60 metres west of the new Haoma mineralised zone. Underground diamond drilling is continuing up dip towards the existing Haoma resource and down dip below 700 vertical metres (refer to Figure 2).

Additionally, multiple mineralised lodes discovered between Daisy Deeps and Haoma are now a key exploration focus (refer to Figure 2). Recent high

grade intersections have included 17.6m at 23.6 g/t of gold. These increase the ounces per vertical metre at depth.

Figure 3 – Mount Monger Drilling Targets



Wombola Dam & Wombola Pit

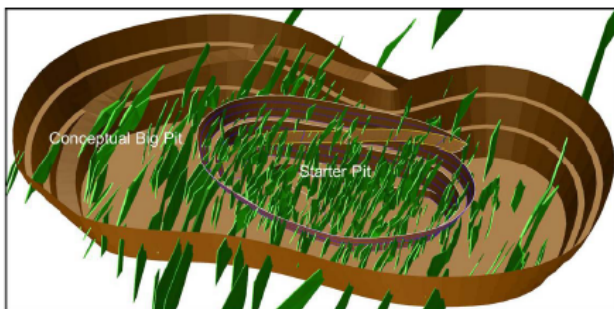
Ore production has commenced at the Wombola Dam open pit (13 September 2011). The Wombola Dam deposit has a current resource of 433kt at 3.9 g/t gold for 54,500oz and will be mined in two stages (refer to Figure 4):

Wombola Dam Stage 1 – The Starter Pit is expected to produce 13,000 recovered ounces over a 9 month period down to a depth of 35 metres at

a strip ratio of 4.8:1 (waste:ore) and at a cash operating cost of A\$432/oz.

Wombola Dam Stage 2 – Big Pit – At the completion of the starter pit further drilling will be carried out below a 35m depth and grade control and depth drilling will be carried out within the conceptual big pit shell. While the drilling and mining study for stage 2 is being completed it is expected, subject to a decision to mine, to commence production at the nearby Wombola Pit deposit.

Figure 4 - Wombola Dam - Starter Pit & Big Pit



Source: Silver Lake Resources

Magic

Results of a mining study on the Magic deposit, located 3 km south of Daisy Milano and with a current resource of 1.8mt at 4.7 g/t gold for 276koz (refer to Table 1, page 8), are expected in the December quarter 2011.

The strike extensions of the deposit have been drilled off and deeper drilling down to 400 metres has been completed. Further deeper drilling will be planned from underground, subject to a decision to mine.

An open pit operation at Magic would be followed by an underground mine. Ore thicknesses to date support a bulk mining method (unlike Daisy Milano).

Resource Inventory >3Moz

SLR has had a target to increase its total gold resource base to 4-5 million ounces by June 2012. The company has a demonstrable track record in building its resource base to the current 3.1Moz of gold (excluding 133koz at the Rothsay Project, which has been sold) as at June 2011.

Over time, the Group's ongoing \$18mpa exploration programme is targeting over 10Moz of gold in total resources.

Anticipation of ongoing growth in SLR's total resources and in reserves underpins our expectation of further upgrades to our base case valuation.

Highlights of the recent Resource inventory include (refer to Table 1 on page 8):

Mount Monger:

- Total resource of 5.1mt at 8.9 g/t of gold for 1.5Moz;
- More than 1Moz of resource is now accessible from existing infrastructure.

The latest inventory does not include all the recent drilling successes, in particular the recent drilling results for the multiple structures between Daisy Deeps and Haoma (refer to figure 2).

Underground drilling programmes continue to target the Haoma deposit and the multiple new structures between Daisy Deeps and Haoma. A further resource upgrade – including expanded resources at Haoma, Daisy Deeps and other resources – will be announced in January 2012.

Murchison:

The total resource in the Murchison is 18.4mt at 2.8 g/t of gold for 1.7Moz (previously: 1.5Moz). A mining reserve will be announced in December 2011.

Total June 2011 Resource:

SLR's resources totalled 24.1mt at 4.2 g/t of gold for 3.3Moz as at June 2011.

In comparison with other ASX-listed gold stocks, SLR does not stand out based on enterprise value per resource ounce. The company ranks slightly above the mean and median on this capitalisation measure. As SLR grows its resource base, its relative ranking on enterprise value per resource (and production) ounce is likely to improve. However, we always maintain that enterprise values per resource (or production) ounce (at any point in time) are a poor predictor of relative value. They obviously ignore operating and capital costs, grade differences, management quality, future resource growth, etc.

Relatively rapid growth in quality resource ounces – as demonstrated by SLR over the past 2-3 years – is almost always viewed positively by the market.

Murchison Project

The definitive feasibility study for the project should be finalised by the end of the 2011CY. Work completed to date supports a production plan of 100kozpa with an 8 to 10 year mine life.

Initial capital cost estimates are likely to include \$30-35m for the plant and around \$25m for pre-strip development. We anticipate that current cash, plus projected cash flow over the next 12 months, will be supplemented by modest debt funding. On our assumptions, SLR will have restored its net cash position by 30 June 2013 (refer below to our estimated cash flow before funding for SLR).

SLR had previously purchased a milling circuit (in good condition and readily relocatable) for only \$3m – comprising a 250tph crushing circuit, a grinding circuit with 3 ball mills and a 7 stage CIL circuit with a plant capacity up to 2.5mtpa – it demonstrates SLR's focus on low cost capital options. The milling circuit is to be configured to the expected 1.2mtpa base load production profile in the Murchison. The parameters for a Murchison gold development will be released late this year with first production early in the 2013CY.

Deeper drilling in the Murchison is ongoing. The company recently reported its best intersection in the current programme of 7.1m at 25.6 g/t of gold from 209m at the Caustons deposit.

Eelya Complex – Copper Targets

Diamond drilling has commenced at Eelya Complex on the company's Murchison leases. Surface geophysics has identified four large electromagnetic conductors at Hollandaire, Colonel, Mount Eelya, and Eelya South (refer to Figure 5).

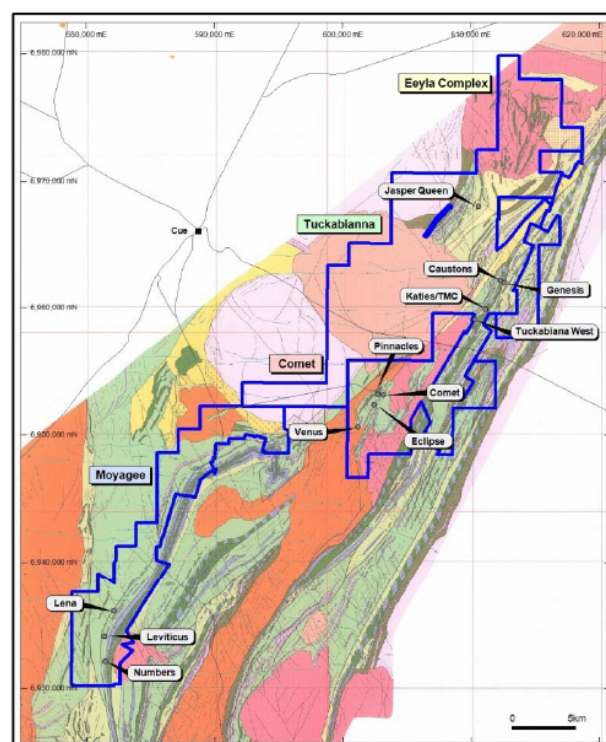
SLR announced on 7 September that two diamond drill holes have been completed at Hollandaire:

- Drill hole 11HODD004 intersected 2m of massive sulphide at 96m depth and 0.8m of massive sulphide at 110m depth;
- Drillhole 11HODD006 intersected 23m of disseminated mineralisation at 100m depth.

Assays are expected in the next 3-5 weeks. Exploration is still at an early stage. However, a felsic volcanic rock complex indicates the potential for volcanogenic massive sulphide mineralisation.

The region is located immediately north of SLR's planned Murchison gold mill. If an ongoing drilling program was to establish a copper resource to enable a development decision, incremental expenditure on an additional grinding mill and flotation circuit (est. cost: around \$20m) would enable production of a copper-gold concentrate.

Figure 5 - Murchison Project Plan



Source: Silver Lake Resources

Summary Cash Flow – Year ending 30 June	2010	2011	2012	2013	2014
A\$m	Act	Act	Est	Est	Est
Mine Operating Surplus	28.8	40.4	94.9	130.5	182.3
Royalties	-2.2	-2.9	-5.4	-7.7	-10.2
Capital Expenditure	-7.7	-23.8	-43.0	-45.5	-20.0
Exploration, evaluation, mining assets	-17.8	-17.0	-17.0	-17.0	-17.0
Working capital changes, Other	-6.0	-9.9	-5.7	-2.8	-1.4
Tax Paid	0.0	0.0	-5.4	-21.2	-27.7
Cash Flow before funding & dividends	-4.9	-13.1	18.4	36.3	105.9

Table 1 - JORC Resources at Mount Monger & the Murchison at June 2011

Deposit	Measured Resources			Indicated Resources			Inferred Resources			Total Resources		
	Ore t '000s	Grade g/t Au	Total Oz Au '000s	Ore t '000s	Grade g/t Au	Total Oz Au '000s	Ore t '000s	Grade g/t Au	Total Oz Au '000s	Ore t '000s	Grade g/t Au	Total Oz Au '000s
Daisy Milano	181.5	30.6	178.6	562.2	17.2	310.9	326	12.3	128.9	1069.7	18.0	618.4
Daisy East	41.0	41.4	54.6	21.4	15.5	10.7	25.9	15.9	13.2	88.3	27.6	78.5
Christmas Flat	-	-	-	338.6	4.05	44.1	448.5	6.33	91.3	787.1	5.3	135.4
Haoma	-	-	-	0	0	0.0	238.9	30.6	235.0	238.9	30.6	235.0
Costello	-	-	-	0	0	0.0	111	4	14.3	111	4.0	14.3
Lorna Doone	-	-	-	0		0.0	128	3.1	12.8	128	3.1	12.8
Magic	-	-	-	749.2	4.08	98.3	1071	5.17	178.0	1820.2	4.7	276.3
Wombola Pit	-	-	-	161.2	3.03	15.7	299	2.77	26.6	460.2	2.9	42.3
Wombola Dam	-	-	-	202.8	4.1	26.7	230.2	3.75	27.8	433	3.9	54.5
Total Mount Monger	222.5	32.6	233.1	2035.4	7.7	506.4	2878.5	7.9	727.9	5136.4	8.9	1467.4
Tuckabianna - OP	-	-	-	4,000.0	2.19	280	4,220.00	2.19	290.0	8,220.0	2.2	570.0
Tuckabianna - UG	-	-	-	1,070.0	4.4	150	1360	4.4	160.0	2,430.0	4.4	310.0
Comet - OP	36	0.6	0.6	2,390.0	2.19	210	670	2.19	40.0	3,070.0	2.2	250.0
Comet - UG	-	-	-	850	4.4	140	250	4.4	30.0	1,100.0	4.4	180.0
Moyagee - OP	-	-	-	840	2.19	60	1,130.00	2.19	90.0	1,980.0	2.2	150.0
Moyagee - UG	-	-	-	70	4.4	10	1,500.00	4.4	190.0	1,570.0	4.4	200.0
Murchison - OP	36.0	0.6	0.6	7,230.0	2.2	550.0	6,030.0	2.2	410.0	13,270.0	2.2	970.0
Murchison - UG	-	-	-	1,980.0	4.4	300.0	3,120.0	4.4	380.0	5,100.0	4.4	680.0
Total Murchison	36.0	0.6	0.6	9,210.0	2.9	850.0	9,150.0	2.7	790.0	18,370.0	2.8	1,650.0
Rothsay	-	-	-	-	-	-	591.2	7	132.9	591.2	7.0	132.9
Total Silver Lake	258.5	28.1	233.8	11245.4	3.8	1356.4	12619.7	4.1	1650.8	24097.6	4.2	3250.7

Source: Silver Lake Resources

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