

23 June 2011

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Initiation Report

# Cerro Resources (CJO AU)

## Initiation: BUY

RESOURCES - AUSTRALIA

- We are initiating coverage of Cerro Resources with a BUY recommendation. The Company is made up of:

- » **Three projects: Cerro Del Gallo**, a gold/silver project in the Guanajuato Mining District of Mexico, within a region of existing infrastructure. **Namiquipa**, an exploration tenement currently being drilled within the silver-lead-zinc rich belt of Chihuahua Mexico, and containing a number of historical workings. **Mount Philp**, an exploration tenement close to Mount Isa currently being drilled with tests yielding high grade iron ore
- » **Strong management:** led by a seasoned team with years of exploration, development and build and operate expertise including recent successful permitting in Mexico. Norman Seckold is Chairman and 8% shareholder, having previously been Director of 9 publicly listed companies, including Bolnisi Gold and Palmarejo Silver & Gold, both Mexican gold/silver projects that merged into Coeur D'Alene for \$1.1bn in 2007

- Investment attractions:

- » **Production within two years from Cerro Del Gallo.** Capital payback in less than two years, operating for over 15 year mine life. Feasibility study complete, we expect a decision to mine to be taken by early 2012.
- » **Resource announcements during Q311.** At **Namiquipa**, given the potential for a large silver deposit to materialise, and containing existing workings, we foresee development of this project over the next 4-5 years using cash generated from Cerro Del Gallo. At **Mt Philp**, there is potential for a high grade hematite deposit with export infrastructure solutions. There is great interest from the industry in such deposits, as we have seen with competing takeover bids for Territory Resources (TTY AU).
- » **Valuation upside.** We have valued the Cerro Del Gallo Project using a DCF model. Base case of 21c per share assuming project expansion to 2027. At spot prices DCF rises to 41c per share. On resource valuation Cerro trades at a significant discount to both producing gold peer group: 179% on EV/Reserve and 99% on EV/Resource and pre-producing gold peer group: 56% on EV/Reserve and 77% on EV/Resource. When we consider Cerro's silver reserves and resources only (no gold), we find it trades at a significant discount to the silver producer peer group: 166% on EV/Reserve and 164% on EV/Resource. **Note both Namiquipa and Mt Philp provide further additional valuation upside**

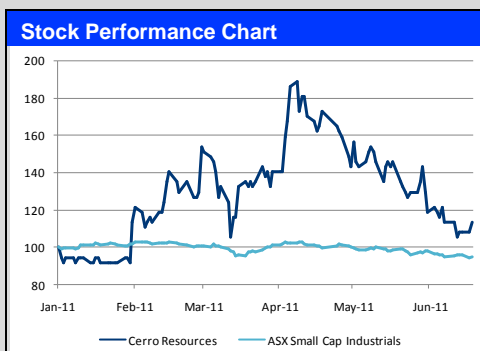
Company data		
Share price	(AUDc)	22
Share price	(USDc)	23
Market cap	(AUDm)	168
6-mth avg daily T/O	(shares m)	2.0
Share outstanding	(m)	748
Free float	(%)	72
52-week range	(AUDc)	7-35
Exchange rate	AUD/USD	1.05

Performance (%)	1m	3m	12m
Absolute	-22	-16	150
Relative*	-16	-12	148

\* Relative to ASX200

Key Financials					
Key Financials (AUD m)	2010A	2011E	2012E	2013E	2014E
Revenue	0	0	0	69	96
EBITDA	-4	-4	-12	38	59
EBIT	-3	-3	-13	30	52
PAT	-3	-3	-13	29	50
Valuation & Growth					
EPS	-0.70	-1.34	-8.02	1.83	7.39
EPS norm growth	30%	-91%	-500%	123%	-304%
PE	-	-	-	5.2	3.0
Net Debt (Cash)	-4	-10	50	36	-19
ND/EBITDA	-	-	-	1.0	-0.3
EV/EBITDA	-	-	-	4.9	2.2
FCF Yield	-	-	-	9%	37%

Source: MF Global



Source: MF Global, Bloomberg

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## OPERATIONS

### Cerro del Gallo, Mexico (65.7%, potential for 90%) Low strip ratio and silver credits trump low gold grades

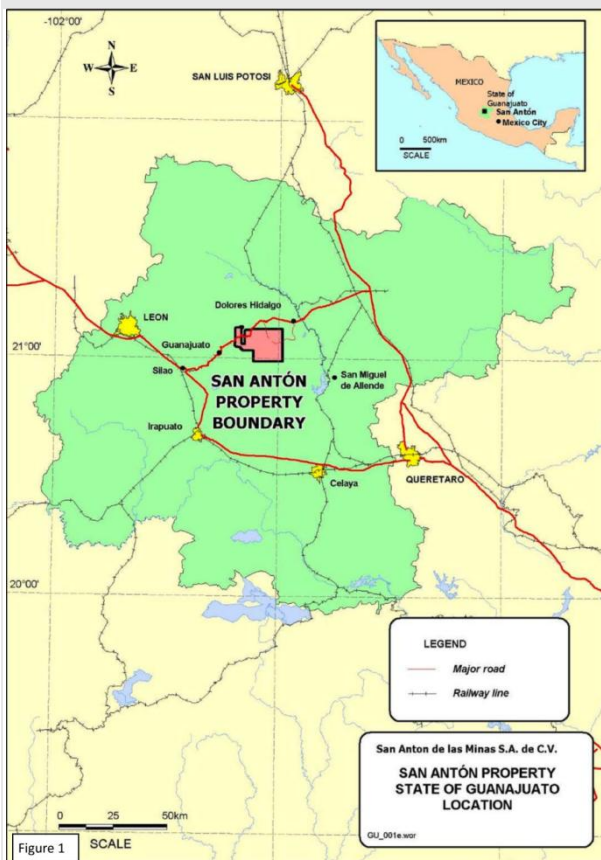
#### Overview

Cerro del Gallo “Rooster Hill” is located within the San Anton property, in the state of Guanajuato in central Mexico, 270 km northwest of Mexico City. Guanajuato Mining District has a long history of silver and gold mining extending going back to 1558, and where production from 1700 to 2004 is reported to have been 1.14 billion ounces of silver and 6.5 million ounces of gold. The Property is located within a region of well established infrastructure; serviced by road, rail, and air services, power and water supplies. Surrounding cities are capable of providing most of the services required for supporting a major mining operation.

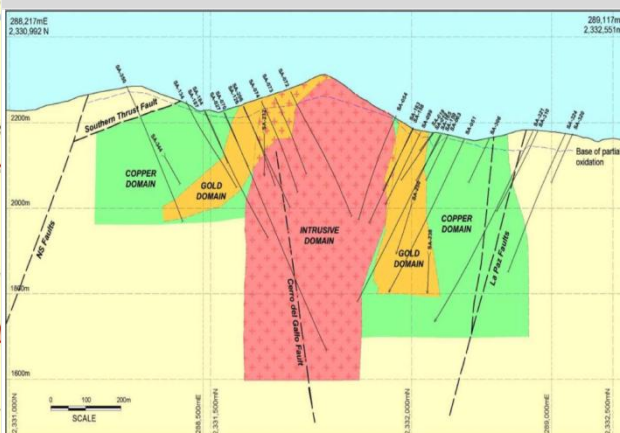
Cerro Resources owns 66% of the project and Goldcorp 34%. If Goldcorp elects not to contribute to capital expenditure, then Cerro will earn-in to 90%.

GRAPHIC NO. 1 | PROJECT LOCATION

GRAPHIC NO. 2 | CERRO DEL GALLO “ROOSTER HILL”



GRAPHIC NO. 3 | CERRO DEL GALLO CROSS SECTION



Source: CJO

## History

- Production records date back to 1860's (and possibly discovered during the Spanish colonial period 1500's).
- 1977 - Consejo de Recursos Minerales commenced assessment work.
- 1982 - The Cooperativa first company to explore the area. Work included rehabilitating the Dolores shaft located on the Carmen-Providencia epithermal trend.
- 1994 - Luismin (now Goldcorp) commenced exploration in the area focused on Cerro del Gallo.
- 2004 -The operating company San Antón de las Minas S.A. de C.V. (SAM) was formed with the signing of a joint venture agreement between Cerro Resources and Luismin.
- 2004-2008 San Anton Resources completes 433 drill holes totaling 114,221m of core and RC drilling.
- Metallurgical, geotechnical and environmental baseline data collection has been ongoing since 2004 to support permitting and feasibility documents.
- Cerro/San Anton has completed NI 43-101 compliant resource estimates in 2006, 2008 and 2010, a Preliminary Economic Assessment in 2010 and a feasibility study in 2011.

## Feasibility Study & Preliminary Assessment

In April 2011, Cerro Resources announced the results of its study work for gold and silver production at Cerro del Gallo, comprising:

- Feasibility Study on the first stage development of the heap leach, with first production from the mine in 2013 until 2020 (years 1-8). Also referred to as "Stage 1"
- Preliminary Assessment study on the second stage of the heap leach (years 9-15) and additional carbon-in-leach (CIL) processing facility (years 5-15), extending production from the mine to 2027. Also referred to as "Expanded Case"

The objective is to first mine the upper part of the hill which is the higher-grade gold/silver rich part of the deposit containing mostly weathered and oxidized material. This ore is amenable to heap leach processing. As the pit mining operations deepen and the ore begins to contain a greater proportion of fresh rock of slightly lower grade sulphide material, a carbon-in-leach (CIL) processing facility would need to be added. Thus both leach facilities will be operating alongside each other for the 10 years from 2018 to 2027, with the remaining weathered and oxidized material being heap leached while fresh rock processing occurs simultaneously via CIL processing.

CHART NO. 1 | STAGE 1 SALES

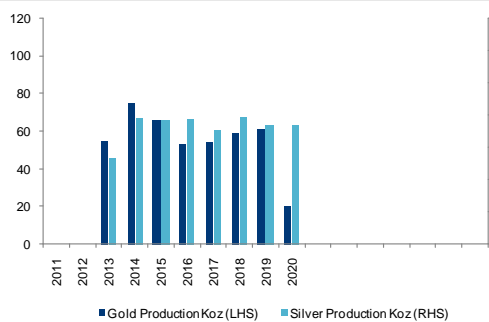
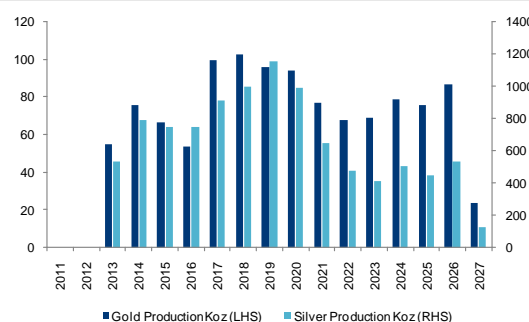


CHART NO. 2 | EXPANDED CASE SALES



Source: MF Global estimates

In the project explanatory analysis which follows we assume constant prices using our long term scenarios for gold (\$1200/oz), silver (\$20/oz). This compares to spot prices at \$1550/oz and \$36/oz respectively. Please see below section for a more detailed scenario valuation analysis which flexes commodity prices, discount rates, and currency. We also assume Cerro funds all capex for the project in order to increase its equity share from 65.7% to 90%.

### Operating Cost Estimates – average for peer group at \$470/oz Au eq (stage 1) and \$560/oz Au eq (stage 2)

Gold grades are low, but Cerro has many positive characteristics which reduce its overall cash costs:

- (1) **Very low strip ratio** (below 0.8), keeping mine cost to \$1.60 life of mine (LOM)
- (2) **High silver content.** Silver will account for 90% of the recovered output. When converting into gold equivalent ounces, assuming a gold/silver ratio of 60, this results in an effective uplift in gold output by around 20%.
- (3) **Recovery rates are industry average but could potentially be much higher** from undertaking more advanced metallurgical test work. For example, indications are that more finely crushing the ore through high pressure grinding roll (HPGR) methods may increase recoveries by more than 5%. CIL processing produces higher gold recoveries despite the lower grade of the sulphide ore being processed. However, silver recoveries reduce with CIL

TABLE NO. 1 | HEAP LEACH AND CIL EXPANSION COMPARISON

	Heap Leach Only	Including CIL Expansion from 2017
<b>Production</b>		
Rock Type Treated	Weathered/Oxidised	Weathered/Oxidised/Sulphide
Years of Operation	2013-2020	2013-2027
Strip Ratio (avg)	0.76	0.81
Ore Processed (kt avg pa)	4,027	5,085
Gold Grade (g/t avg)	0.63	0.57
Silver Grade (g/t avg)	12.1	12.2
Gold Recovery (avg)	60%	62%
Silver Recovery (avg)	33%	29%
Gold Sales (koz avg pa)	55	75
Silver Sales (koz avg pa)	731	670
% Gold	7%	11%
% Silver	93%	89%
Gold Eq. Sales (koz avg pa)	68	86
<b>Price assumptions</b>		
Gold (\$/oz)	1200	1200
Silver (\$/oz)	20	20
<b>Revenue</b>		
Gold Revenue (USDm avg pa)	66	90
Silver Revenue (USDm avg pa)	15	13
Total Revenue (USDm avg pa)	81	103
<b>Costs</b>		
Total Cash Costs per Gold eq. ounce	473	561

Source: MF Global estimates

**Capital Cost Estimates – low at equivalent ratio of \$195/oz Au eq output (Stage 1) and \$146/oz Au eq output (expanded case)**

Sedgman has provided the capital cost estimate for the first stage heap leach processing facilities and is continuing with engineering design work. The Mines Group in Reno, USA has completed pad and pond design, hydrological assessment and pit slope analyses for the first stage.

The table below summarises the capital costs for the first stage heap leach project development. These costs have been estimated from actual quotes for new equipment, estimates based on other similar operations and general unit costs plus contingencies appropriate for this level of study. The changes compared with the 2010 Scoping Study capital estimate are the exclusion of the overland conveyor due to the heap leach pad location now being closer to the pit, inclusion of a third crushing stage at start-up, additional water supply cost estimate and increased initial throughput from 4.0 to 4.5mtpa. The cost estimates for the water supply dam, infrastructure (laboratory, workshops and buildings) and mobile equipment were prepared internally under supervision of John Skeet.

The table also shows owners costs associated with the first stage heap leach development. This cost will be funded as part of development with some of the Other Owners Costs being required prior to construction for environmental permitting and land acquisition. A significant portion of these additional costs (US\$7.65M) are in the start-up non-cash flow period and covers full estimated operating costs for three months.

Additional mining sustaining capital of US\$11.9M will be required to complete stage one mining. The startup mining capital estimates assume an owner operated fleet at the commencement of operations for the 4.5mtpa heap leach. No decision has been made on whether to utilise an owner operated fleet or to contract mine. Contract mining will be investigated and if used, will reduce capital requirements by but will likely increase operating costs.

TABLE NO. 2 | HEAP LEACH AND CIL EXPANSION COMPARISON (US\$M)

Stage 1: 4.5mtpa Heap Leach		Expanded Case: 3.0mtpa CIL	
<b>Direct Cost</b>		<b>Direct Cost</b>	
Crushing	18.8	Process	45.3
Agglomeration	7.5	Tailings Storage Facility	5.0
Heap leach	9.0	Infrastructure	6.9
Gold/silver plant	9.1	Subtotal	57.2
Reagents	0.1		
Services	1.9	<b>Indirect Costs</b>	
Infrastructure	1.5	EPCM	8.6
Water Supply Dam	1.9	Construction	2.9
Subtotal	49.9	Subtotal	11.4
		Direct + Indirect	68.6
<b>Indirect Costs</b>		Owners Costs	3.4
EPCM	9.5	Contingency (15%)	10.8
Insurance	0.8		
Mobile Equipment	0.6	<b>TOTAL</b>	<b>82.9</b>
First fill	0.9		
Subtotal	11.8		
Direct + Indirect	61.7		
Contingency (15%)	9.3		
Total	70.9		
<b>Owners Costs</b>			
Working Capital (3mths)	7.7		
Spares	1.0		
Capital spares	1.0		
Other	4.9		
Contingency (15%)	2.2		
Total	16.8		
<b>Start Up Mining Capital</b>			
Primary Mining Equipment	9.4		
Support Equipment	4.5		
Blasting	0.2		
Mine Maintenance	0.5		
Other Mine Capital	3.2		
Total	17.9		
<b>TOTAL</b>	<b>105.6</b>		

Source: MF Global estimates &amp; Cerro

### Cashflow and Returns – very strong even at long term prices due to low operating and capital costs

- (1) **High EBITDA margins** averaging close to 60% even at long term prices due to the low operating cost. EBITDA averages between \$40-50m per annum and NPAT \$30-35m per annum in both cases
- (2) **Quick payback on capital expenditure**, just 2 years
- (3) **Capital efficient**, with net cashflow (nominal) paying back capital costs 2.4x (Stage 1) and 3x (Expanded Case)
- (4) **Relatively stable underlying operational cashflows**, given the stable production profile, grade and recoveries. The average and median net cashflows (after capex) for both Stage 1 and the expanded cases are between \$30-35m per annum.

TABLE NO. 3 | HEAP LEACH AND CIL EXPANSION COMPARISON

	Heap Leach Only	Including CIL Expansion from 2017
<b>Cashflow</b>		
EBITDA (USDm avg pa)	43	49
Margin (% avg pa)	61%	53%
PAT (USDm avg pa)	30	33
Capex (USDm cumulative)	106	189
Net cashflow undiscounted pre tax (USDm)	254	561
Capital payback (years)	2.0	2.0
Capex/ Gold eq. oz (USDm)	195	146
Capital efficiency (net cashflow / capex)	2.4	3.0

CHART NO. 3 | STAGE 1 NET CASH FLOWS

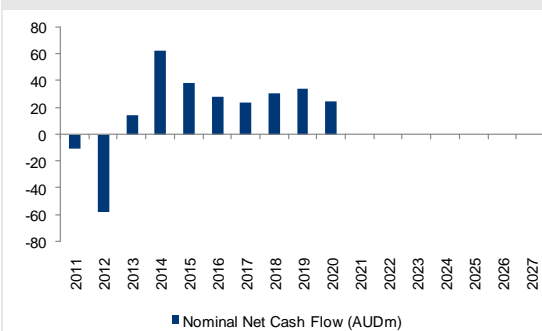


CHART NO. 4 | EXPANDED CASE NET CASH FLOWS

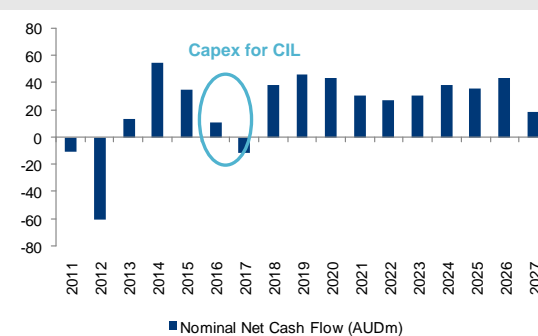


CHART NO. 5 | STAGE 1 NET DEBT

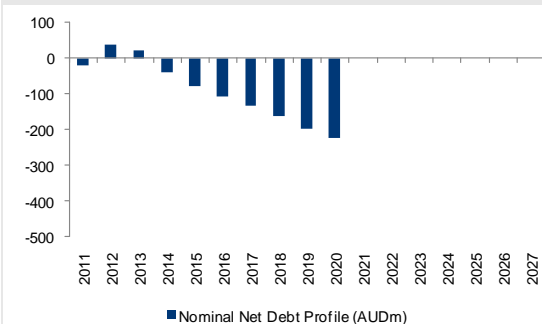
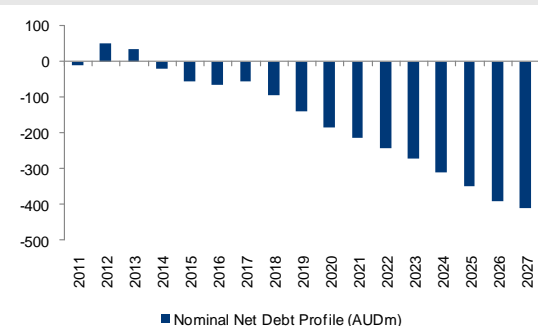


CHART NO. 6 | EXPANDED CASE NET DEBT



Source: MF Global estimates

## Funding Growth

Cerro has \$20m in cash (no debt) on the balance sheet as of May 2011. Aside from exploration expenditure at Namiquipa (c.\$8m) and Mount Philp (c.\$2m) in 2012, cash and funds will be directed towards the Cerro Del Gallo Project. If Goldcorp elect to not contribute to capex then Cerro will increase its equity share to 90% (from 65.7%), which is our assumption. Thus the total funding requirement to first sales is close to \$70m (\$90m capital costs less \$20m in cash). There are various options available:

- Mixture of straight equity and debt
- Potential for forward selling of some future production in exchange for capital now
- Sell down or sale of the 100% owned Mount Philp project (see project details in Mount Philp section). A sell down or sale could be possible. An initial resource statement for the Northern section is due late in Q3 with further work continuing into 2012. There is very high demand from the trade for iron ore assets that have potential infrastructure solutions, particularly outside of the Pilbara. A good example being Territory Resources (TTY AU).

Territory sells 2.2mtpa of hematite (60% grade) per annum from its Frances Creek mine located 200km south of Darwin, shipping through the Port of Darwin. Two takeover offers are currently outstanding for Territory Resources at \$120 and \$130m, one by Exxaro and the other by Noble Group (a cornerstone shareholder).

- We view a potential sell down or sale of the 100% owned Namiquipa Project as less likely for Cerro Del Gallo funding purposes, given that the project is located in Mexico and involving silver (both specialties of management). If anything Namiquipa would potentially be a good USE of the cash generated from Cerro Del Gallo in future years. We expect the Group to await further details on the scale and grade of the resource to assess the optionality around potential production.

**Given that valuations on Mount Philp is difficult to determine at this stage and hence timing very uncertain, we believe Cerro may look to initially raise \$40-50m to commence construction at the Cerro Del Gallo Project.**

### Valuation Scenario Analysis

We have valued the Cerro Del Gallo Project using a DCF model. In our base case scenario we assume (into perpetuity) \$1200/oz gold, \$20/oz silver, 1:1 AUD:USD, and 10% WACC. We do not include any equity dilution from capital raising. This generates a value for the Cerro Del Gallo Project of \$77m or 10c per share for Stage 1, and \$156m or 21c per share in the expanded case.

At spot metal prices and exchange rates (\$1540/oz gold, \$36/oz silver, 1.06:1.0 AUD) the valuation increases dramatically to \$170m or 23c per share for Stage 1, and \$308m or 41c per share in the expanded case.

TABLE NO. 4 | CERRO DEL GALLO: DCF VALUATION SCENARIO ANALYSIS STAGE 1 ONLY

Market Cap AUDm							Share price AUDc						
WACC 10%		Gold \$/oz					WACC 10%		Gold \$/oz				
	77.24	800	1,000	1,200	1,400	1,600	10.32	800	1,000	1,200	1,400	1,600	
Silver \$/oz	10	-26	13	53	93	132	10	-4	2	7	12	18	
	15	-14	26	65	105	144	15	-2	3	9	14	19	
	20	-2	38	77	117	156	20	0	5	10	16	21	
	25	10	50	89	129	169	25	1	7	12	17	23	
	30	22	62	101	141	181	30	3	8	14	19	24	
		WACC							WACC				
	77.24	14%	12%	10%	8%	6%	10.32	14%	12%	10%	8%	6%	
AUD/USD	1.10	41	51	62	75	91	1.10	5	7	8	10	12	
	1.05	47	57	69	83	100	1.05	6	8	9	11	13	
	1.00	53	64	77	92	109	1.00	7	9	10	12	15	
	0.95	61	72	86	102	120	0.95	8	10	11	14	16	
	0.90	69	81	96	113	132	0.90	9	11	13	15	18	

Source: MF Global estimates

TABLE NO. 4 | CERRO DEL GALLO: VALUATION SCENARIO ANALYSIS EXPANDED CASE

Market Cap AUDm							Share Price AUDc						
WACC 10%		Gold \$/oz					WACC 10%		Gold \$/oz				
	155.88	800	1,000	1,200	1,400	1,600		20.83	800	1,000	1,200	1,400	1,600
Silver \$/oz	10	-20	51	122	192	263	Silver \$/oz	10	-3	7	16	26	35
	15	-2	68	139	209	280		15	0	9	19	28	37
	20	15	85	156	227	297		20	2	11	21	30	40
	25	32	102	173	244	314		25	4	14	23	33	42
	30	49	119	190	261	331		30	7	16	25	35	44

WACC		AUD/USD					WACC		AUD/USD				
	155.88	14%	12%	10%	8%	6%		20.83	14%	12%	10%	8%	6%
AUD/USD	1.10	92	109	130	156	190	AUD/USD	1.10	12	15	17	21	25
	1.05	101	120	142	171	207		1.05	14	16	19	23	28
	1.00	111	131	156	187	225		1.00	15	18	21	25	30
	0.95	123	144	171	204	246		0.95	16	19	23	27	33
	0.90	135	159	187	223	269		0.90	18	21	25	30	36

Source: MF Global estimates

### Reserves & Resources – Significant Potential To Extend Project Life

Mine Development Associates (MDA) of Reno, USA completed the mining study and the table below shows their estimate for the proven and probable reserves for the first stage (8 years of heap leaching) plus the preliminary assessment additional in-pit measured and indicated resources for the expanded case. It is important to note that:

- Pit optimization and design for both the Feasibility Study (Stage 1) and the Preliminary Assessment (expanded case) were based on US\$1,020/oz gold and US\$16.40/oz of silver. These assumptions below our expectation for long term prices of \$1200/oz and \$20/oz respectively, and considerably below spot prices of \$1540/oz and \$36/oz. A higher price assumption could surely increase the reserve and resource statement materially.

TABLE NO. 5 | RESERVES AND RESOURCES

Category	Kt	Au g/t	Au Koz	Ag g/t	Ag Koz
Feasibility Proven Reserves	28,246	0.71	643	15.05	13,664
Feasibility Probable Reserves	3,971	0.54	69	13.20	1,685
<b>Feasibility 2P Reserves</b>	<b>32,217</b>	<b>0.69</b>	<b>712</b>	<b>14.82</b>	<b>15,349</b>
PA Measured Resources	39,888	0.66	850	14.32	18,358
PA Indicated Resources	5,125	0.61	100	10.07	1,659
<b>Preliminary Assessment M&amp;I Resources</b>	<b>45,013</b>	<b>0.66</b>	<b>951</b>	<b>13.83</b>	<b>20,017</b>
<b>Total Resource and Reserve</b>	<b>77,231</b>	<b>0.67</b>	<b>1,663</b>	<b>14.24</b>	<b>35,366</b>

2P gold equivalent cutoff grades of 0.21 and 0.29 g/t for weathered and partially oxidized material respectively. Gold equivalent cut off grade for M&I resource is 0.35 g/t.

Source: CJO

In addition to the large open pit deposit at Cerro del Gallo there are a number of low sulphidation epithermal targets that have only been partially tested. Additional drilling will be needed to fully evaluate the depth potential of these narrow silver-gold systems that were the focus of earlier programs largely because of the similarity of the vein systems to the prolific Guanajuato deposits. Significant intersections have been found, including:

- 1.5m @ 590g/t Ag and 3.40g/t Au
- 4.6m @ 428g/t Ag and 3.52g/t Au
- 3.6m @ 359g/t Ag and 1.57g/t Au
- 4.6m @ 239g/t Ag and 1.91g/t Au
- 6.0m @ 243g/t Ag and 1.70g/t Au
- 3.1m @ 200g/t Ag and 1.05g/t Au
- 7.6m @ 168g/t Ag and 1.51g/t Au

#### **Carmen-Providencia System**

- The Carmen-Providencia quartz epithermal vein system is composed of three segments: Empalizada, Dolores and Espiritu Santo segments. Empalizada and Dolores are located 1.7km to the west of Cerro del Gallo. The Espiritu Santo segment is approximately 2km west of Cerro del Gallo.
- Empalizada and Dolores are located 1.7km to the west of Cerro del Gallo. The Espiritu Santo segment is approximately 2km west of Cerro del Gallo.

#### **Ave de Gracia System**

- The Ave de Gracia quartz epithermal system extends 1.5 km from the Dolores shaft to where the system intersects the west side of Cerro del Gallo.
- To date this system has only been tested by 460m of drilling in four RC doles.

#### **San Luis Rey System**

- The San Luis Rey epithermal system is located to 3.6km south of Cerro del Gallo.
- 13 drill holes (RC and DDH) were drilled totaling 1,768m.

TABLE NO. 6 | CERRO DEL GALLO P&amp;L BASE CASE MODEL FOR EXPANSION TO 2027

PROJECT @ 100%		TOTAL	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
AUD			1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
\$/oz	Gold price				1200	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200	1200
\$/oz	Silver price				20	20	20	20	20	20	20	20	20	20	20	20	20	20	20
	Ratio				60	60	60	60	60	60	60	60	60	60	60	60	60	60	60
kt	Waste Mined	62,100			200	1100	1800	2500	6300	9300	9600	8700	8600	5300	3500	2400	1800	1000	0
kt	Ore Mined	76,270			4600	4990	4700	5400	6300	5300	5900	6300	5180	4900	4700	5300	5500	6100	1100
	Strip Ratio	0.81			0.04	0.22	0.38	0.46	1.00	1.75	1.63	1.38	1.66	1.08	0.74	0.45	0.33	0.16	0.00
kt	Total processed	76,270			4,600	4,990	4,700	5,400	6,300	5,300	5,900	6,300	5,180	4,900	4,700	5,300	5,500	6,100	1,100
g/t	Gold grade	0.57			0.58	0.58	0.64	0.63	0.62	0.63	0.62	0.54	0.53	0.53	0.53	0.53	0.53	0.53	0.53
g/t	Silver grade	12.2			15.8	15.5	10.9	11.0	11.2	11.0	11.1	11.9	12.1	12.1	12.1	12.1	12.1	12.1	12.1
%	Gold recovery	62%			75%	75%	56%	59%	62%	58%	60%	60%	60%	60%	60%	60%	60%	60%	60%
%	Silver recovery	29%			40%	38%	30%	28%	27%	28%	28%	28%	28%	28%	28%	28%	28%	28%	28%
koz	Gold sales	1,125			55	76	67	54	100	103	96	94	77	68	69	79	76	87	24
koz	Silver sales	10,047			534	790	750	749	913	1001	1156	992	652	479	415	504	451	533	128
koz	Total	11,172			589	866	817	803	1013	1104	1252	1086	729	547	484	583	527	620	152
%	Gold	11%			9%	9%	8%	7%	10%	9%	8%	9%	11%	12%	14%	14%	14%	14%	16%
%	Silver	89%			91%	91%	92%	93%	90%	91%	92%	91%	89%	88%	86%	86%	86%	86%	84%
koz	Gold Eq.	1,292			64	89	80	66	115	120	115	111	88	76	76	87	84	96	26
<b>Revenue</b>																			
US\$m	Gold	1,350			66	91	80	65	120	124	115	113	92	82	83	95	91	104	29
US\$m	Silver	201			11	16	15	15	18	20	23	20	13	10	8	10	9	11	3
US\$m	Total	1,551			77	107	95	80	138	144	138	133	105	91	91	105	100	115	31
<b>Costs</b>																			
US\$/t	Mining cost	1.60			1.47	1.48	1.62	1.62	1.62	1.62	1.62	1.62	1.62	1.62	1.62	1.62	1.62	1.62	1.62
US\$/t	Processing costs	5.17			4.55	4.85	4.64	5.10	5.56	5.04	5.36	5.27	5.31	5.31	5.29	5.30	5.30	5.30	5.30
US\$/t	G&A costs	0.64			0.64	0.64	0.64	0.64	0.64	0.64	0.64	0.64	0.64	0.64	0.64	0.64	0.64	0.64	0.64
US\$/oz	Refining costs gold	1.50			1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
US\$/oz	Refining costs silver	0.25			0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
%	Royalties	4%			4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%
US\$/oz	Total all oz	69			58	47	48	59	65	54	53	62	79	91	93	83	93	85	63
US\$/oz	Total Au oz	644			622	540	589	875	654	582	693	715	748	729	653	613	641	605	402
US\$/oz	Total gold eq.	561			536	460	496	711	567	501	577	608	656	652	593	554	584	549	369
US\$/oz	Total gold (inc silver credit)	480			428	332	365	598	471	387	452	504	579	588	532	485	523	482	295
<b>Costs</b>																			
US\$	Mining cost	223			7	9	11	13	20	24	25	24	22	17	13	12	12	12	2
US\$	Processing costs	395			21	24	22	28	35	27	32	33	27	26	25	28	29	32	6
US\$	G&A costs	49			3	3	3	3	4	3	4	4	3	3	3	3	4	4	1
US\$	Refining costs gold	2			0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
US\$	Refining costs silver	3			0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
US\$	Royalties	62			3	4	4	3	6	6	6	5	4	4	4	4	4	5	1
US\$	Total	421			34	41	39	47	65	60	66	67	58	50	45	48	49	53	10
<b>EQUITY SHARE @ 90%</b>																			
AUDm	Revenue	1,396			69	96	86	72	124	129	124	119	95	82	82	94	90	104	28
AUDm	EBITDA	737			38	59	50	29	66	75	65	59	43	37	41	51	46	56	20
%	Margin	53%			55%	62%	59%	41%	53%	58%	52%	49%	45%	46%	51%	54%	51%	54%	69%
AUDm	Less Depreciation	-133			(8)	(8)	(13)	(13)	(13)	(13)	(13)	(13)	(5)	(5)	(5)	(5)	(5)	(5)	(5)
AUDm	EBIT	346			30	52	37	16	52	62	51	46	38	32	36	45	41	51	14
AUDm	Net Interest	69			(2)	(1)	1	2	2	2	3	4	5	6	7	8	9	10	12
AUDm	PBT	672			29	50	38	18	54	64	54	50	43	38	43	54	50	61	26
AUDm	Less Taxes	-172			(11)	(5)	(16)	(18)	(16)	(14)	(13)	(13)	(11)	(13)	(16)	(15)	(18)	(18)	(8)
AUDm	PAT	500			29	50	27	13	39	45	38	35	31	27	31	38	36	43	18
AUDm	Expansion capex				(10)	(60)	(20)		(10)	(58)	(15)								
AUDm	Maintenance capex				(3)	(3)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)
	<b>Net Cash Flow To Firm</b>	<b>389</b>			<b>-10</b>	<b>-60</b>	<b>14</b>	<b>55</b>	<b>35</b>	<b>11</b>	<b>-11</b>	<b>38</b>	<b>47</b>	<b>44</b>	<b>31</b>	<b>28</b>	<b>31</b>	<b>38</b>	<b>44</b>

Source: MF Global estimates

**OPERATIONS**

**Namiquipa, Mexico (100%)**  
 Significant Silver Exploration Potential

The Namiquipa Project is located approximately 145 kilometres west-north-west of Chihuahua City. The area has been mined since the 19<sup>th</sup> century and extensive records remain. Several targets have been flagged for drilling after analysing the historical data. Previous operations extracted millions of ounces of silver at grades of over 500g/t. Geologically; Namiquipa is strongly analogous to the Fresnillo-style of poly-metallic vein systems which are silver rich and gold poor. Cerro controls north/south extensions of known vein systems, and includes the prospective La Venturosa Silver Mine. La Venturosa was the site of underground mining operations for silver, lead and zinc from 1929–1936, 1948–1955 and 1990-2002. Mining has taken place over a strike length of just 1,250m and to a depth of only 250m. There is significant upside exploration potential.

**Drilling commenced in May and test results should be announced in Q3. We expect Cerro to aim towards beginning pre-feasibility study over the next twelve months. Given the potential for the deposit, and existing workings, we expect Cerro to develop this project over the next 4-5 years using cash generated from Cerro Del Gallo.**

**Historical production:**

- 14.37moz silver
- 32,550t lead (produced from 1.16mt mined oxide/sulphide material)
- 43,530t zinc (from just sulphide material)

GRAPHIC NO. 4 | NAMIQUIPA AERIAL VIEW



GRAPHIC NO. 5 | NAMIQUIPA LOCATION



Source: CJO

**OPERATIONS**

**Mount Philp, Queensland (100%)**  
 High Grade Haematite Potential With Infrastructure Solutions

The Mount Philp Ironstone is situated 54 km southeast of Mt Isa. Mount Philp is within 25km of the Mt Isa/Townsville highway, rail and electricity supply infrastructure. The project is at an exploration stage and consists of an exposed outcrop of iron. Project milestones:

- » 3.7 km strike haematite iron outcrop above surface identified (Nov 2010)
- » 68% average iron content post simple beneficiation (crushing/ screening) in recent test work (Dec 2010)
- » Drilling commenced in April over the 1.5km northern section. A second rig was introduced in June. Initial assay results are due in early July, and an inferred resource announcement is anticipated by the end of calendar year 2011

We regard Mount Philp as non-core given Cerro Resources' Mexican focus. A sell down or sale could be possible. An initial resource statement for the Northern section is due late in Q3 with further work continuing into 2012. There is very high demand from the trade for iron ore assets that have potential infrastructure solutions, particularly outside of the Pilbara. A good example being Territory Resources (TTY AU). Territory sells 2.2mtpa of hematite (60% grade) per annum from its Frances Creek mine located 200km south of Darwin, shipping through the Port of Darwin. Two takeover offers are currently outstanding for Territory Resources at \$120 and \$130m, one by Exxaro and the other by Noble Group (a cornerstone shareholder). Territory has 5mt of reserve and 10mt of resource, supporting a mere 2-5 year mine life.

GRAPHIC NO. 6 | MT PHILP



Source: Cerro

GRAPHIC NO. 7 | MT PHILP DRILL SECTION



## OPERATIONS

### Kalman, Queensland (20-40%) JV Restructure Focuses Efforts Onto Main Projects

The 1031km<sup>2</sup> Kalman molybdenum-rhenium-copper-gold deposit is situated 62 km southeast of Mt Isa. The project is at a pre-feasibility stage.

On May 16 Cerro entered into a farm out agreement with Syndicated Metals Ltd (SMD AU, not rated). SMD can earn up to 80% of the project for AUD3m in stock and AUD11m in exploration spend. The agreement highlights management focus on Cerro Del Gallo whilst retaining an interest in future potential upside.

## VALUATION AND PERFORMANCE

### Peer Analysis

The first table below compares junior global gold companies on production, resource multiples, and costs. A few observations:

- » We expect Cerro's cash costs to be USD468/oz gold eq. in line with its peer group.
- » Cerro trades at a significant discount to producing peer group: 179% on EV/Reserve and 99% on EV/Resource
- » Cerro trades at a significant discount to pre-producing peer group: 56% on EV/Reserve and 77% on EV/Resource
- » We note the substantial exploration upside that we expect to be announced at Namiquipa and Cerro Del Gallo

TABLE NO. 7 | JUNIOR PEER OPERATIONS

Name	Asset Location	Share		EV	Production (koz)		Reserves	Resources	EV/Reserves	EV/Resources	Cash Cost 2012E
		Price	Mkt Cap		2011E	2012E					
<b>Juniors (Producing)</b>		USD	USDm	USDm							USD/oz
New Gold	Global	9.07	3,636	3,356	392	428					308
Semafo	Africa	6.91	1,882	1,692	273	306	2.5	6.7	680	254	543
Alamos	Europe	15.05	1,756	1,554	190	230	2.4	6.3	651	248	343
High River	Global	1.10	925	782	333	238	2.4	4.3	326	182	613
Aurizon	North America	5.14	834	686	166	170	0.9	6.0	798	114	464
Highland Gold	CIS	2.42	788	604	218	253		6.8		89	
Northgate	Asia-Pacific	2.49	726	608	201	283	2.7	10.5	225	58	642
Avocet	Global	2.90	578	615	248	247	1.3	4.5	466	137	590
Mineral Deposits	Africa	7.25	441	386	136	176	1.6	3.5	241	110	575
Jaguar	Latin America	4.36	368	528	220	302	2.0	7.6	265	70	543
Rusoro	Latin America	0.25	135	134			1.8	13.5	73	10	
<b>Average</b>			<b>1,097</b>	<b>995</b>	<b>238</b>	<b>263</b>	<b>2.0</b>	<b>7.0</b>	<b>414</b>	<b>127</b>	<b>513</b>
<b>Median</b>			<b>788</b>	<b>615</b>	<b>219</b>	<b>250</b>	<b>2.0</b>	<b>6.5</b>	<b>326</b>	<b>112</b>	<b>543</b>
<b>Juniors (Pre-producing)</b>											
Osisko Mining	North America	14.61	5,585	5,651	335	648	7.6	11.3	744	500	371
Gabriel	Europe	6.44	2,245	2,129			13.7	19.8	156	108	
Detour Gold	North America	26.83	2,248	1,665		73	11.4	19.0	146	87	276
Novagold	North America	8.78	2,052	2,401			17.3	28.0	139	86	
European Goldfields	Europe	9.54	1,753	1,708	96	143	9.0	11.0	190	155	246
Centamin	Africa	1.88	2,052	1,903	241	306	9.1	14.5	209	131	472
China Gold	China	3.64	1,441	1,400	148		4.1	7.8	345	180	
G-Resources	China	0.09	1,228	990		174	2.7	6.5	364	152	603
Dundee	CIS	7.71	965	929	141	152	2.7	5.1	344	182	456
Rubicon	North America	4.00	858	809		67					188
Great Basin Gold	Global	1.66	755	929	267	358	4.2	15.0	220	62	594
Greystar Resources	Latin America	2.47	208	109	145		8.6	12.7	13	9	553
Charaat Gold	CIS	0.59	149	139				4.0		35	
Kentor Gold	CIS	0.11	118	47		33		1.1		43	
Alhambra Resources	CIS	0.67	70	68	20	22		1.4		49	565
Hambledon Mining	-	0.07	50	49	36	71	0.4	2.1	125	23	398
Oxus Gold	CIS	0.02	6	19	183	-	1.2	3.6	16	5	
<b>Average</b>			<b>1,281</b>	<b>1,232</b>	<b>163</b>	<b>169</b>	<b>7.1</b>	<b>10.2</b>	<b>232</b>	<b>113</b>	<b>429</b>
<b>Median</b>			<b>965</b>	<b>929</b>	<b>148</b>	<b>143</b>	<b>7.6</b>	<b>9.4</b>	<b>190</b>	<b>87</b>	<b>456</b>
<b>Cerro</b>	<b>Mexico</b>	<b>0.21</b>	<b>159</b>	<b>153</b>	<b>68*</b>		<b>1.0</b>	<b>2.4</b>	<b>148</b>	<b>64</b>	<b>473</b>
<b>Discount to average junior producer</b>									<b>179%</b>	<b>99%</b>	
<b>Discount to average junior pre-producer</b>									<b>56%</b>	<b>77%</b>	

\* 2012/13

Source: MF Global, Factset, Bloomberg

The second table below compares global silver companies on resource multiples. A few observations:

- » Given the rarity factor, silver only or mostly silver exposed companies trade at a premium
- » When we consider Cerro's silver reserves and resources ONLY (no gold), we still find it trades at a significant discount to the silver producer peer group: 166% on EV/Reserve and 164% on EV/Resource
- » We note the substantial exploration upside that we expect to be announced at Namiquipa and Cerro Del Gallo

TABLE NO. 8 | JUNIOR PEER OPERATIONS

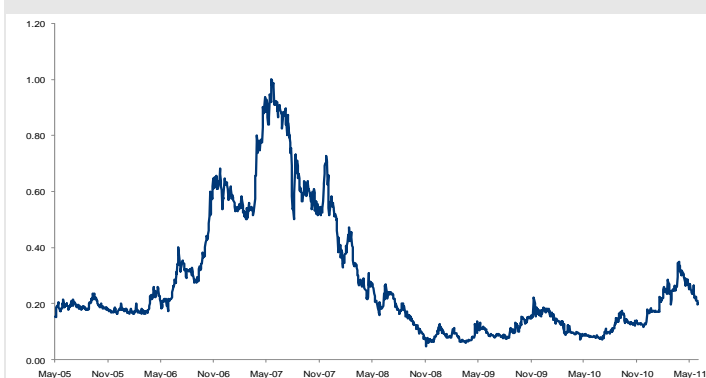
Name	Asset Location	Share Price	Mkt Cap	EV	Reserves	Resources	EV/Reserves	EV/Resources	Cash Cost 2012E
		USD	USDm	USDm	Ag Moz	Ag Moz	USD/oz	USD/oz	USD/oz
Fresnillo	Mexico	21.48	15,405	15,051	374	1,289	48	48	
Industrias Penoles	North America	37.18	14,778	14,888	619		24		
Polymetal	CIS	22.00	8,786	9,466	369	622	26	15	
Pan American	South America	27.87	3,007	2,619	224	419	19	19	
Hochschild	South America	7.28	2,463	2,402	64	224	56	56	
Tahoe Resources	North America	18.05	2,582	2,134		317		7	
Coeur d'Alene	South America	22.99	2,058	2,199	248	484	13	13	
Hecla mining	North America	6.99	1,952	1,645	132	325	17	17	
Silver Standard Res.	Global	24.24	1,947	1,805	286	1,397	6	1	
First Majestic Silver	Mexico	16.75	1,731	1,651	46	283	36	6	
<b>Average</b>			<b>5,471</b>	<b>5,386</b>	<b>239</b>	<b>595</b>	<b>27</b>	<b>20</b>	
<b>Median</b>			<b>2,522</b>	<b>2,301</b>	<b>248</b>	<b>419</b>	<b>24</b>	<b>15</b>	
<b>Cerro</b>	<b>Mexico</b>	<b>0.21</b>	<b>159</b>	<b>153</b>	<b>15</b>	<b>20</b>	<b>10</b>	<b>8</b>	
<b>Discount to average junior producer</b>							<b>166%</b>	<b>164%</b>	

Source: MF Global, Factset, Bloomberg

## Share Price Performance

- » On a long term chart, we can see that Cerro is trading well below its pre-financial crisis highs despite stronger precious metal prices, greater resource identification, having added the Namiquipa project to its asset base, and having completed a feasibility study on Cerro Del Gallo and being closer to production.

CHART NO. 7 | HISTORICAL SHARE PRICE



Source: MF Global, Bloomberg

## MANAGEMENT & SHAREHOLDERS

### Management

Cerro is led by a seasoned team with years of exploration, development and build & operate expertise including recent successful permitting in Mexico.

» **Norman A Seckold, Non-Executive Chairman (Since July 2001)**

Norman Seckold graduated with a Bachelor of Economics degree from the University of Sydney in 1970. He has spent over 25 years in the full time management of natural resource companies, both in Australia and overseas. Mr Seckold has been the Chairman and Director of 9 previously publicly listed companies, including Bolnisi Gold NL and Palmarejo Silver & Gold which successfully merged with Coeur D'Alene Mines in 2007; and Mongul Mining NL which drilled out the Magistral and Ocampo Gold deposits in Mexico. Mr Seckold is also currently Chairman and Director of Cockatoo Coal Limited, Augur Resources Ltd and Planet Gas Ltd.

» **James A Crombie, Executive Vice Chairman (Since October 2010)**

Mr Crombie graduated from the Royal School of Mines, London, in 1980 with a B.Sc. (Hons) in Mining Engineering. Post a 20 year career within multinational mining companies and as a mining analyst and investment banker, Mr Crombie held the position of President and CEO of Ariane Gold Corp and Palmarejo Silver and Gold Corporation. He is currently President, CEO and a director of Reunion Gold Corporation, Avala Resources and Odyssey Resources Limited, CEO, Executive Vice Chairman, and Director of Queensland Minerals Limited, and a director of Arian Silver Company and Sutter Gold.

» **Anthony J McDonald, CEO and Managing Director (Since October 2010)**

Tony McDonald graduated from the Queensland University of Technology, Brisbane, in 1981 with a Bachelor of Laws degree and was admitted as a solicitor in 1982. Mr McDonald has been involved in the natural resources sector in Australia and internationally for many years and in the past 10 years has been actively involved in management in the resources sector. He was an executive director of Kings Minerals NL (now Cerro Resources NL) from 1996 until March 2007. Currently, Mr McDonald is a non-executive director of Industrea Limited and Planet Gas Limited.

» **Craig J McPherson, Alternate Director, Corporate Secretary and CFO (Corporate Secretary since March 2007)**

Craig McPherson graduated with a Bachelor of Commerce degree from the University of Queensland and is a member of the Institute of Chartered Accountants in Australia. Prior to joining Cerro Resources, Mr McPherson spent 10 years in senior management positions as a chartered accountant. Over this time he developed extensive experience in areas of business, financial and strategic management. Mr McPherson was a Director of San Anton Resource Corporation Inc which completed a Business Combination with Kings Minerals NL (now Cerro Resources NL) in September 2010.

» **John S Skeet, Chief Operating Officer (Since May 2009)**

Mr Skeet is a Metallurgist with more than 20 years experience in the mining and resources sector. Formerly Project Manager for Bolnisi Gold NL and managing the Palmarejo Silver and Gold Project prior to the successful merger with Coeur D'Alene, Mr Skeet has also been responsible for the successful development of Bolnisi's gold heap leach operation in the Republic of Georgia and was the General Manager for Valdora Minerals NL's projects and operations where he was responsible for the first gold production in the famous gold

producing city of Ballarat, Victoria, in over 80 years. He has significant and relevant experience with the types of projects Cerro Resources NL is developing.

### Shareholders

There are 748m shares on issue. There are 48.55m options outstanding, with strike prices between \$0.12-0.60.

TABLE NO. 9 | SHAREHOLDERS

Holder	Holdings	%
1 Norman Seckold	62,533,907	8.36
2 OCJ Investment	42,047,545	5.62
3 HSBC Nominees	33,264,581	4.45
4 Guina Developments	30,000,000	4.01
5 Mr Terrence William Kahler & Mrs Suzanne Kahler	24,000,000	3.21
6 National Nominees Limited	23,852,471	3.19
7 JP Morgan Nominees Australia Limited	16,485,546	2.2
8 UBS Nominees	15,341,420	2.05
9 Robert Bell	15,223,397	2.04
10 CS Fourth Nominees	13,990,563	1.87
11 Anthony McDonald	13,500,000	1.8
12 JP Morgan Nominees	12,042,680	1.61
13 Mr Robert Dahl & Mrs Merril Dahl	11,000,000	1.47
14 Baillie Walker Investments	7,866,748	1.05
15 Mr & Mrs Domenica Catalano & Mr Angelo Catalano	7,161,875	0.96

Source: Cerro

### Risks

Key risks to our BUY recommendation on Cerro are (1) gold and silver price fluctuations (2) project timeline and cost movements (3) ability to prove up reserve to meet expanded production case (4) ability to generate successful exploration results

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## APPENDICES

### Industry Analysis

#### GOLD

##### SHORT TERM OUTLOOK

- A key reason why gold did not get swept up in the general selling that engulfed most other commodities during May has to do with the fact that all the major issues that are currently weighing on various markets i.e. the Euro crisis, the turmoil in the Middle East, and deadlocked budget and debt negotiations in the US, seem to be constructive for gold. Simply put, investors are seeking gold's safety as they begin to question the purchasing power of fiat currencies worldwide. We think gold may continue to push higher on the concerns for a little while longer, and would not be surprised to see the old highs taken out over the course of July given the messy Euro situation and the US budget negotiations. By year's end, gold could trade between \$1650-1700, since on an inflation adjusted basis going back to 1980, prices are still relatively cheap, and will only exceed the 1980 highs if we push above \$2300 an ounce.

##### DEMAND AND SUPPLY

- In terms of fundamental end-use, jewelry remains the most important driver despite now accounting for less than half of gold demanded (from 80% ten years ago). Whilst jewelry fabrication should continue to grow due to wage growth in emerging economies, we note that it gold has been losing market share to 'white' jewelry (mostly platinum) for the past five years. Miners have now completely unwound their hedge books, which has accounted for about 10% of gold demand each year for the past decade. That really leaves investment and ETF growth, which is largely a function of the macro factors described above, and hence forecasting demand is becoming increasingly difficult.
- Supply is somewhat easier to determine. We expect mine supply to grow only by around 1-2% given the structural headwinds of declining grades and maturing mines. South African production has declined for most of the past decade. Scrap, which is cyclical, could make up around 35% of supply this year, compared to its 10 year average of 25% due to high prices.

##### PRICING

- When looking back at over 500 years of history, gold pricing has been affected little by supply imbalances even during times of the South African gold rush. Demand was always 'created' to satisfy supply - usually through monetary vehicles. With so many competing forces it is difficult to determine which of the following is the dominant driver of the gold price: (1) collapse of fiat money (2) inflation hedge (3) volatility hedge. We are firm believers that China and India as buyers of gold on price weakness as they gradually increase gold holdings as a portion of their central bank reserve holdings. Also central banks in developed economies have also begun increasing their gold purchases, reversing years of trend decline, whilst at the same time their relative buying of US Treasuries appears to be falling. There is also huge potential in the increasingly popular gold accumulation accounts offered to retail investors in China – a new innovative way of creating demand. Hence, what really drives our gold forecasts is money supply, having observed a >90% correlation and income growth in China and India. Real rates are negative in US, Europe, and China and when coupled with QE of some form (in US, Europe, and UK) then we see support for gold in the near term. Gold has fallen sharply relative to silver. It is currently trading at 43x the silver price, versus a 50yr average of 50x

and a 20yr average of 65x. When looking at gold prices in real terms they are still well below their peak of \$2300/oz in 1980. Given the economic turmoil believe and dollar headwinds we believe this is possible but note there were also events which also helped drive the price that high (the time of Bunker Hunt in silver).

- Outlook beyond the current year is difficult to determine. The fundamental question is whether the US does recover, and whether the Fed is resigned to further quantitative easing and/or loose monetary conditions. We believe in a continued debasement of the dollar and hence a favorable environment for gold. The major risk are dramatically rising yields. Gold crashed from its 1980 peak as Volcker hiked interest rates to fight hyperinflation. In real terms, the 110yr average real price has been \$450/oz, and the 50yr is \$550/oz. A purely marginal cost (90th percentile) approach would suggest prices are supported around \$800/oz.

## SILVER

### SHORT TERM OUTLOOK

- Silver's correction seems to have run its course, as prices have recovered somewhat after dropping to a low of just above \$32, slightly above the \$31 target we had identified back in May. Despite rumours of LME margin decreases, we do not think investors will be rushing into silver any time soon given the horrendous selling experience they went through in May. Money continues to flow out of the silver backed ETFs, although not by the same extent as was evidenced in May. We expect to see a trading range market in silver continue for a little while longer, and see price between \$32 and \$39 at least for the next two months

### DEMAND AND SUPPLY

- Even more so than with gold, silver's fundamental demand drivers are weakening relative to investor demand. Fabrication for photography applications has declined by 60% in the past decade. Industrial applications and jewelry have remained fairly steadily but are price sensitive. Within these end-markets, growth economies are steadily increasing their market share. Again investors today make up the main source of demand. Holding physical coins remains very popular with retail investors (coins and medals make up 10% of demand), seen particularly recently based upon macro concerns that also drive a desire to hold physical gold either directly or through an ETF.
- Silver production is largely as a byproduct to the much larger markets of copper, gold, and lead/zinc, and silver recoveries are somewhat dependant on the prices of these primary metals. We expect mine supply to therefore increase around 2-3%.

### PRICING

- Whilst silver has higher industrial exposure than gold, price formation is also largely correlated to macro and monetary policy. The gold price is currently 43x the silver price, a ten year low. The 50yr average is 65x and the 20yr average 50x. In real terms the silver price rose to above \$100/oz in 1980, when Nelson Bunker Hunt was accused of cornering the market and as hyperinflation set in. Then the ratio fell to below 20x. The subsequent crash in silver was much more fierce and protracted, with the ratio rising to as high as 100x ten years later. The long term average price in real terms since 1950 is \$12/oz. A purely marginal cost (90th percentile) approach would suggest prices are supported around \$19/oz.

TABLE NO. 10 | GOLD SUPPLY AND DEMAND

GOLD											
Supply (t)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010E
Mine Production	2,620	2,646	2,618	2,623	2,494	2,549	2,483	2,473	2,410	2,584	2,652
Net Producer Hedging	-15	-151	-412	-289	-438	-92	-434	-444	-352	-252	-50
<b>Total Mine Supply</b>	<b>2,606</b>	<b>2,495</b>	<b>2,206</b>	<b>2,334</b>	<b>2,057</b>	<b>2,457</b>	<b>2,049</b>	<b>2,029</b>	<b>2,058</b>	<b>2,331</b>	<b>2,602</b>
Official Sector Sales	479	520	547	620	479	663	365	484	232	30	0
Scrap	620	749	874	986	881	902	1,133	982	1,316	1,672	1,654
<b>Total Supply</b>	<b>3,705</b>	<b>3,764</b>	<b>3,626</b>	<b>3,940</b>	<b>3,417</b>	<b>4,023</b>	<b>3,547</b>	<b>3,494</b>	<b>3,606</b>	<b>4,033</b>	<b>4,256</b>
Demand (t)											
	2005	2006	2007	2008	2009	2010E					
Jewelry	3,205	3,009	2,662	2,484	2,616	2,718	2,298	2,418	2,193	1,758	2,038
Other	557	474	481	515	555	581	650	672	696	658	702
<b>Total Fabrication</b>	<b>3,762</b>	<b>3,483</b>	<b>3,143</b>	<b>2,999</b>	<b>3,172</b>	<b>3,299</b>	<b>2,948</b>	<b>3,089</b>	<b>2,889</b>	<b>2,415</b>	<b>2,740</b>
Bar Hoarding	242	261	264	180	257	264	235	237	386	212	456
Net Investment	0	20	220	760	0	459	365	169	331	1,406	879
<b>Total Demand</b>	<b>4,003</b>	<b>3,764</b>	<b>3,626</b>	<b>3,940</b>	<b>3,428</b>	<b>4,023</b>	<b>3,547</b>	<b>3,495</b>	<b>3,606</b>	<b>4,033</b>	<b>4,074</b>

TABLE NO. 11 | SILVER SUPPLY AND DEMAND

SILVER										
Supply (t)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Mine Production	18,381	18,856	18,472	18,557	19,068	19,805	19,935	20,665	21,297	22,072
Net Producer Hedging	-852	587	-772	-651	299	859	-211	-753	-360	-694
<b>Total Mine Supply</b>	<b>17,529</b>	<b>19,443</b>	<b>17,700</b>	<b>17,906</b>	<b>19,367</b>	<b>20,664</b>	<b>19,724</b>	<b>19,912</b>	<b>20,937</b>	<b>21,378</b>
Official Sector Sales	1,874	1,961	1,841	2,759	1,924	2,051	2,433	1,322	858	426
Scrap	5,621	5,684	5,830	5,721	5,713	5,786	5,849	5,654	5,476	5,155
<b>Total Supply</b>	<b>25,024</b>	<b>27,087</b>	<b>25,371</b>	<b>26,387</b>	<b>27,004</b>	<b>28,501</b>	<b>28,005</b>	<b>26,889</b>	<b>27,270</b>	<b>26,958</b>
Demand (t)										
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Other Industrial	7,850	7,096	6,820	7,487	7,949	9,773	10,751	12,123	12,297	10,228
Photography	6,790	6,628	6,353	5,999	5,562	4,987	4,428	3,881	3,263	2,577
<b>Total Industrial</b>	<b>16,640</b>	<b>15,725</b>	<b>15,176</b>	<b>15,489</b>	<b>15,515</b>	<b>16,765</b>	<b>17,184</b>	<b>18,010</b>	<b>17,568</b>	<b>14,815</b>
Jewelry	5,306	5,422	5,252	5,574	5,438	5,406	5,172	5,084	4,922	4,870
Coins	999	948	983	1,110	1,318	1,246	1,237	1,235	2,028	2,447
Silverware	6,790	6,628	6,353	5,999	5,562	4,987	4,428	3,881	3,263	2,577
<b>Total Fabrication</b>	<b>27,734</b>	<b>26,721</b>	<b>25,763</b>	<b>26,169</b>	<b>25,830</b>	<b>26,398</b>	<b>26,015</b>	<b>26,203</b>	<b>25,773</b>	<b>22,700</b>
Net Investment	0	365	0	218	1,174	2,103	1,990	685	1,498	4,258
<b>Total Demand</b>	<b>27,735</b>	<b>27,087</b>	<b>25,763</b>	<b>26,387</b>	<b>27,004</b>	<b>28,501</b>	<b>28,006</b>	<b>26,889</b>	<b>27,271</b>	<b>26,958</b>

Source: Bloomberg, MF Global

CHART NO. 9 | GOLD/SILVER HISTORICAL RATIO

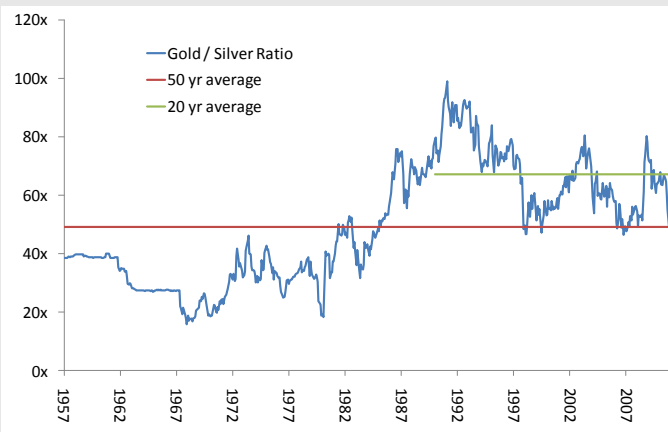
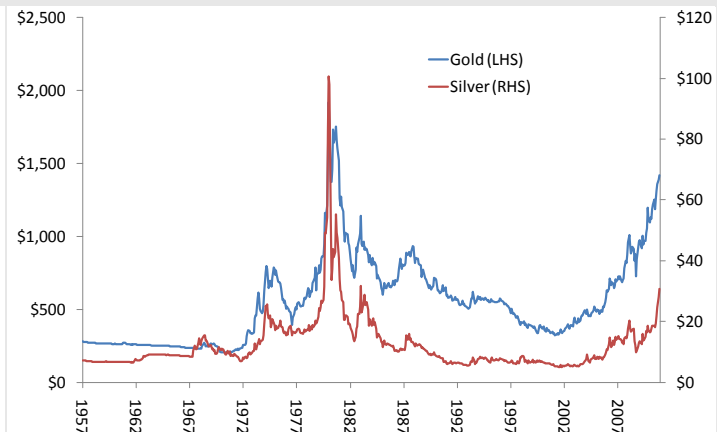


CHART NO. 10 | GOLD AND SILVER HISTORICAL REAL PRICES



Source: MF Global, Datastream

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