AMBRIAN

Metals & Mining

Archipelago Resources

Buy

Site Visit and Finance

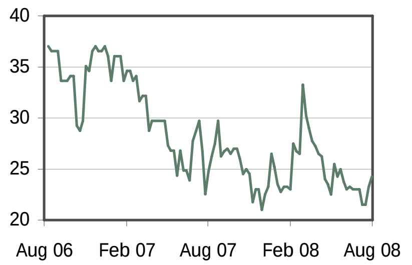
26 August 2008

Upcoming Events
Equity funding (3Q08)
Construction start (4Q08)
Debt drawdown (1Q09)
Commercial production (3Q09)

Market cap	**£49.2m**
Ticker	**AR.**
Price	**24.5p**
Target price	**46p**
EV / Resource oz (US$/oz)	52
EV / Reserve oz (US$/oz)	95
Est. cash costs (US$/oz)	382
52-week (p)	
High	35
Low	20
3M-avg daily vol (000)	403.6
3M-avg daily val (£000)	91.8
Shares	
Basic	**201.15**
Fully diluted	**242.2***
Top shareholders	
Baker Steel	9.6%
Asia Image	9.6%
JP Morgan	7.0%
MLP Investment	6.4%
Total	**32.6%**

**Post estimated US$20m raise (25p/share)*

Share Price Performance (p)



Source: Fidessa

Ambrian acts as Broker to and Market Maker for this company

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Archipelago has announced that it intends to use Credit Suisse to provide US$48m in debt for the Toka Tindung gold project in Indonesia. We estimate capex will have escalated by 10% since previous estimates of US$60m, implying Archipelago will need some US$18m in equity to fund the project into production. The company has indicated that it intends to develop relationships with domestic associates of Credit Suisse, which we believe may lead to the final equity placing.

Following our site visit we are comfortable that all licences required for construction are in place and that the environmental design of the project is to exceptionally high standards. Should the company pursue domestic equity funding this will give investors added confidence ahead of debt financing (which we don't expect to be drawn down until equity is spent).

We retain our BUY recommendation and have updated our target 1x NPV$_{10\%}$-based target price from 52p to 46p. Key changes are additional equity dilution from the £4.6m raised this year, and upcoming equity which we model at 25p. Once in production we would expect the company to trade at a multiple to NPV, but this is hard to quantify given the depressed state of the equity markets. We also believe that, once in production, the quality of the asset will make Archipelago a takeover target for both international and domestic miners.

Toka Tindung NPV Sensitivities to 2011+ Gold Price and Discount Rate

		Gold Price US$/oz 2011+			
	550	**650**	**687**	**800**	**1,000**
12.5%	32	39	41	49	63
10.0%	36	43	**46**	55	71
7.5%	40	49	52	62	80
		2009E	**2010E**	**2011E**	**2012E+**
Gold price	**(US$/oz)**	956	925	780	687

Source: Ambrian estimates

Despite historic delays, we forecast production from 3Q09. The high-grade, open-pit mine should support production of over 160,000oz pa from free milling ore. Major items are on site, including mills and crushers. The mill is partly built, and contract construction and mining should mitigate commissioning delays.

Ambrian Financial Forecasts for Archipelago Resources

Yr to Dec 31	**2009E**	**2010E**	**2011E**	**2012E**
Production (000oz Au eq.)	62,536	177,718	175,272	187,803
Revenue (£m)	32.0	87.7	72.7	69.0
EBITDA (£m)	9.2	48.1	33.3	32.3
EV/EBITDA*	6.4x	1.2x	1.8x	1.8x
EPS (p)*	0.1	11.8	7.6	6.6
P/E *	189.0x	2.1x	3.2x	3.7x

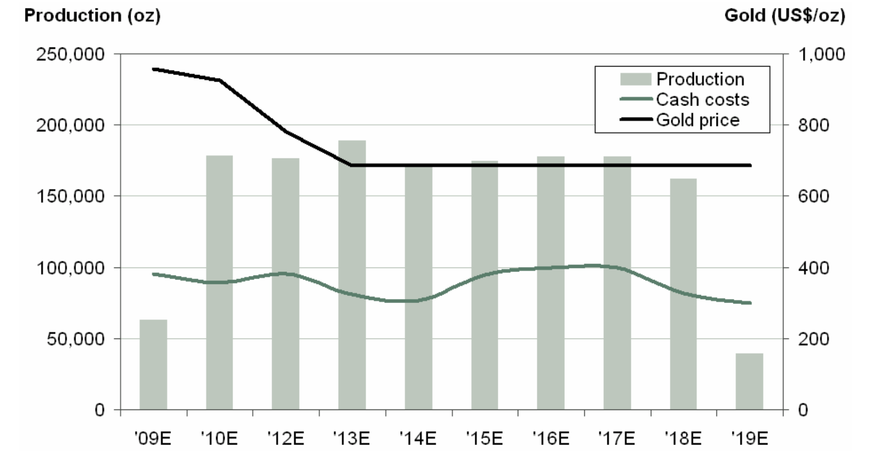
***Based on fully funded 242m shares; Source**: Ambrian estimates

Valuation

Post-tax 1x NPV valuation of US$189m for Toka Tindung

We value Toka Tindung at 1x $NPV_{10\%}$ of US$189m on an attributable project basis, based on post-tax project free cashflow for Toka Tindung, with 15% minority interest removed after the recoup of carried debts. Debt finance of US$48m has been modelled; equity dilution is assumed at 25p for residual capex of US$18m (estimated capex US$66m — 10% above historic estimate). We model production from 3Q09.

Production Profile and Cash Costs Modelled for the Toka Tindung Project



Source: Ambrian estimates

Cash at year end was US$8.3m, with the US$8m debt facility scheduled for repayment in August. Based on repayment of debt and estimated burn of US$0.75m/month, we estimate the company has US$2m cash remaining.

Operating Model for the Toka Tindung Gold Project

Yr to Dec	2009E	2010E	2011E	2012E
Ore processed (Mt)	0.63	1.70	1.70	1.70
Gold head grade (g/t)	3.19	3.30	3.23	3.39
Gold recovered (000oz)	60,775	170,932	166,793	178,250
Silver recovered (000oz)	106,559	410,583	512,970	577,992
Gold eq recovered (000oz)	62,738	178,495	176,242	188,896
Gold price (US$/oz)	957	925	780	687
Silver price (US$/oz)	15.5	14.2	12.0	12.0
Revenue (US$m)	59.3	162.3	134.5	127.6
Operating cost per ounce (US$/oz Au)	382	355	381	323
Operating cost per ounce (US$/oz Au eq)	370.0	340.4	360.7	304.8
Operating costs (US$m)	23.2	60.8	63.6	57.6
Royalties (US$m)	1.4	3.9	3.2	3.0
Project operating profit (US$m)	34.7	97.7	67.8	67.0
Net finance income (US$m)	-2.2	-1.8	2.9	5.0
Tax (US$m)	9.4	28.8	20.7	21.1
Minority interest (US$m)	0.0	0.0	0.0	2.1
Project cash flow (US$m)	23.0	67.0	50.0	48.8

Source: Ambrian estimates

Discounted Cashflow for Toka Tindung

Yr to Dec	2008E	2009E	2010E	2011E	2012E
Project cashflow (US$m)	0.0	23.0	67.0	50.0	48.8
Less capex (US$m)	10.0	56.0	0.0	0.0	0.0
Free cashflow (US$m)	-10.0	-33.0	67.0	50.0	48.8
Discount rate (10%)	10.0%				
NPV (US$m)	189				

Source: Ambrian estimates

Recommendation — BUY, Target Price 46p

Currently trading at a discount to NPV based on commissioning and financing risk — significant upside offered

Archipelago Resources is currently trading around 0.45x NPV; when in full production this could rise to over 1.5x NPV if market sentiment improves. Share price drivers are: (1) equity funding; (2) initiation of construction; and (3) meeting production timelines for 3Q09. As it stands, construction is part-complete (storage dams, jetty, foundations, part fabrication, mill on-site, etc). As such, although risk remains, as investors have a solid idea of the economics of the project — and the project has received a mandate from the State Government to proceed — we believe a 1x NPV valuation is warranted. This equates to 46p/share.

Fair Value Calculation for Archipelago Resources

Present value of FCF (US$m)	189	
£/US$	1.85	
NPV multiplier (x)	1.0	
Shares in issue post equity raise* (m)	242	
NAV (£m)	102	42p/share
Estimated net cash post equity raise (£m)	9.2	4p/share
NAV (£m)	112	46p/share

*Assumes US$18m raised at 25p; **Source**: Ambrian estimates

Currently trading at 0.45x NPV

The current share price is clearly trading at a 55% discount to NPV. Much of this discount is related to the remaining perceived political risk surrounding permitting of the project, with delays caused by the historic opposition to the mine from the local governor. Also, with equity and debt financing to be completed, dilution and hedging requirements are not yet finalised.

Once in full production a 1.25x NPV should be achievable

Construction comes with risk; with many gold projects running behind schedule at the construction phase, delays often come from difficulties in securing basic equipment (pipes, wiring, tyres, etc) and manpower. Thus, once in production and construction is fully de-risked (currently targeted for 2H09), a 1.25x NPV multiple should be considered achievable, even in the current market conditions (57p/share). This offers potential returns of 130% over 12-18 months.

Site Visit

Construction and Infrastructure

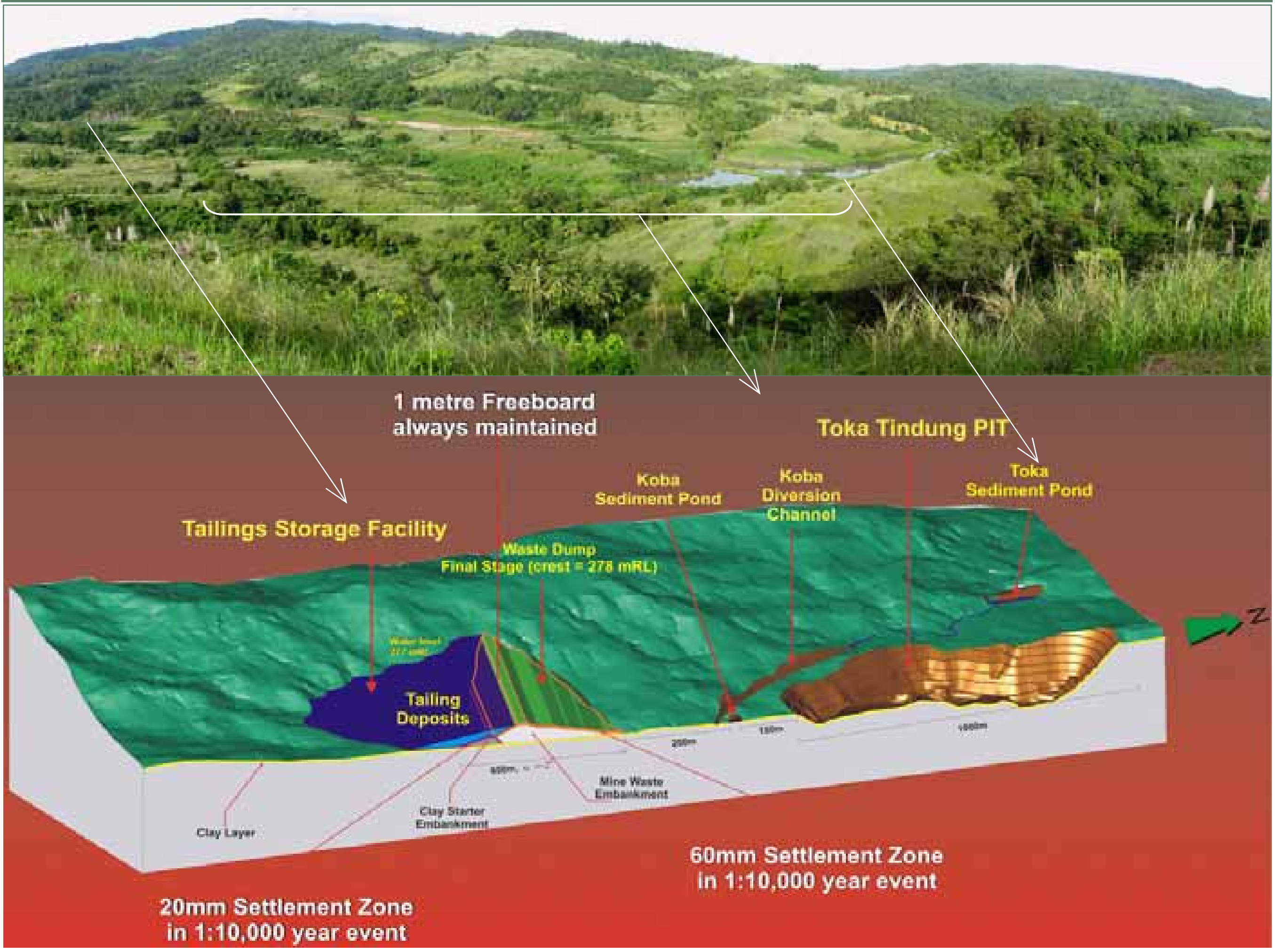
The Toka Tindung mine is located in a valley 6km from the ocean. Ore is located in the main Toka Tindung pit, as well as in four other separate pits around 2km south of the plant site. Following the decision to revert to onshore (rather than marine tailings) disposal, the project was redesigned in 2006, and construction began at that time. Major items were delivered to site, including a rotary crusher, ball mill and SAG mill, as well as leach tanks and steel for fabrication of the mill. Construction was halted in March 2007 after delays in granting the AMDAL. Thus, the progress made to date will shorten the remaining construction period.

(A) Mill Framework, (B) Leach Tanks, (C) Ball Mill and Machinery, and (D) Steelwork for Rotary Crusher

Source: Ambrian

The mining and processing site has been designed to exceptionally high standards, with key parts such as the tailings dam wall designed to withstand major earthquakes. The company has designed the waste dump to act as the tailings dam wall, which is progressively stacked higher. This arrangement is ultra-secure, and ensures that even earthquakes are unlikely to disrupt the layout. Furthermore, the tailings — from which all cyanide is removed by a detoxification plant — are located upstream of the pit itself. The entire arrangement also has numerous overflow and diversion channels and drains, water treatment plants (to remove silt), and settlement ponds. In fact, the company intends to release water back into natural drainages with only 50ppm suspended silt, well beneath the 200ppm Indonesian Government requirement.

Photograph and Schematic of the Mine and Tailings Storage Sites Looking West



Source: Archipelago Resources, Ambrian

Geology

The Toka Tindung gold deposit is a structurally controlled mesothermal orogenic gold deposit. Ore is hosted in a series of steeply dipping conjugate shear zones. Gold mineralisation is preferentially hosted within a volcano-sedimentary sequence within a large basaltic andesite unit, which provided a competency contrast and favourable geochemical conditions for gold mineralisation.

Resource for 85%-owned Toka Tindung Gold Deposit, Indonesia

Category (JORC '04)	Tonnes (Mt)	Gold grade (g/t)	Silver grade (g/t)	Gold (Moz)	Silver (Moz)
Measured	2.20	3.6	8.0	0.25	0.56
Indicated	11.04	3.2	8.0	1.13	2.84
Inferred	2.23	4.3	8.0	0.31	0.57
Resource	**15.46**	**3.42**	**8.0**	**1.70**	**3.98**

Source: Company data

Cross Section Through the Toka Tindung Deposit Showing Original Drilling and New (Vertical) Drill Hole

Source: Archipelago Resources

Resource Upside

The priority for Archipelago is, and must remain for the coming year, the commissioning of Toka Tindung. Beyond this we remain positive that the deposit, discovered in 1994, shows potential for continued growth.

Depth Extensions

The majority of defined resources are based on drilling less than 75m depth, undertaken by initial owner Aurora Resources. Subsequent to acquisition, Archipelago undertook a deeper drilling programme, which clearly showed that the main ore zone continues at depth. In the above diagram the vertical hole shows this, grading 12m @ 9.5 g/t gold outside the existing resource. In our view this is clear evidence that the deposit will ultimately support an underground mining operation.

Strike Extensions

While the main Toka Tindung shear zones continue for many kilometres, it is the confluence of such a lineament with at least one, and normally multiple, geological features which triangulate the deposit to a specific point. At Sinter Barat, approximately 3.5km NNE of Toka Tindung on the same main lineament, a gold-soil anomaly is coincident with a cross-cutting structure. Rock chip and channel samples are extremely encouraging: 16 samples have returned grades from 2.5-40 g/t gold, with an average of 8.8 g/t gold. For that reason this target is highly prospective for an additional satellite resource.

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