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Silver Lake Resources (SLR)

Recommendation: Speculative Buy 25 May 2008

Initiating Coverage – Undervalued!

- **We are initiating research coverage of Silver Lake Resources, at $0.375 per share, with a Speculative Buy recommendation.**
- **SLR reported its first gold pour at its Mount Monger Project in April 2008.**
- **Our base case valuation for SLR is $0.60 per share (fully diluted, allowing for 26m unlisted options), based on: a 5 year Mount Monger mine life to 2013 (at 50-70kozpa); excluding any value for the Murchison Goldfield; using a 5% discount rate ($0.53 per share at a 10% discount rate); and our gold price and $A/US rate assumptions.**
- **Our upside valuations for SLR, to around $1.00 per share, assume the Lakewood Mill is at capacity (for most of 2009-2013) and include a modest valuation of the Murchison Goldfield.**
- **Risks include establishing sufficient resources - to underpin our base case and upside case valuation estimates - plus all the usual technical risks attached to narrow vein underground mining and gold price risk. The company appears to have a very capable Board (all ex-WMC) and management.**

Share price:	**$0.375**				
52 week price range:	**$0.28/$0.50**				
Market capitalisation ($m):	**67**				
Year to 31 December	**2007**	**2008**	**2009**	**2010**	**2011**
	Act	Est	Est	Est	Est
Adjusted Profit	-7.2	0.4	15.2	21.9	20.7
EPS (fully diluted)[1] (cps)	-4.0	0.2	8.4	12.2	11.5
P/E ratio (x)	n/a	n/a	4.4	3.1	3.3
DPS (c)	0.0	0.0	0.0	0.0	0.0
Assumptions					
Gold produced (koz)	0	10	49	72	63
$A/US	0.788	0.892	0.940	0.895	0.825
Gold (US$/oz)	638	832	915	850	810

Background

Silver Lake Resources announced that it had poured the first gold at its Lakewood Gold Processing Facility in April 2008. It follows the acquisition of 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 increasingly appears highly favourable to SLR. Silver Lake's Mount Monger Operation, including the Daisy Milano mine, is located 50 km SE of Kalgoorlie. The separate purchase (30 November 2007) and refurbishment of the Lakewood Gold Processing Facility (cost: $2.4m; plus $4.6m included installation of a gravity circuit), located 5 km east of Kalgoorlie and 45 km from Daisy Milano, adds further value (replacement cost would now be: $25m, plus extended delays for mill delivery).

Mount Monger Goldfield

Silver Lake commenced operations at Daisy Milano in December 2007 with the following objectives:

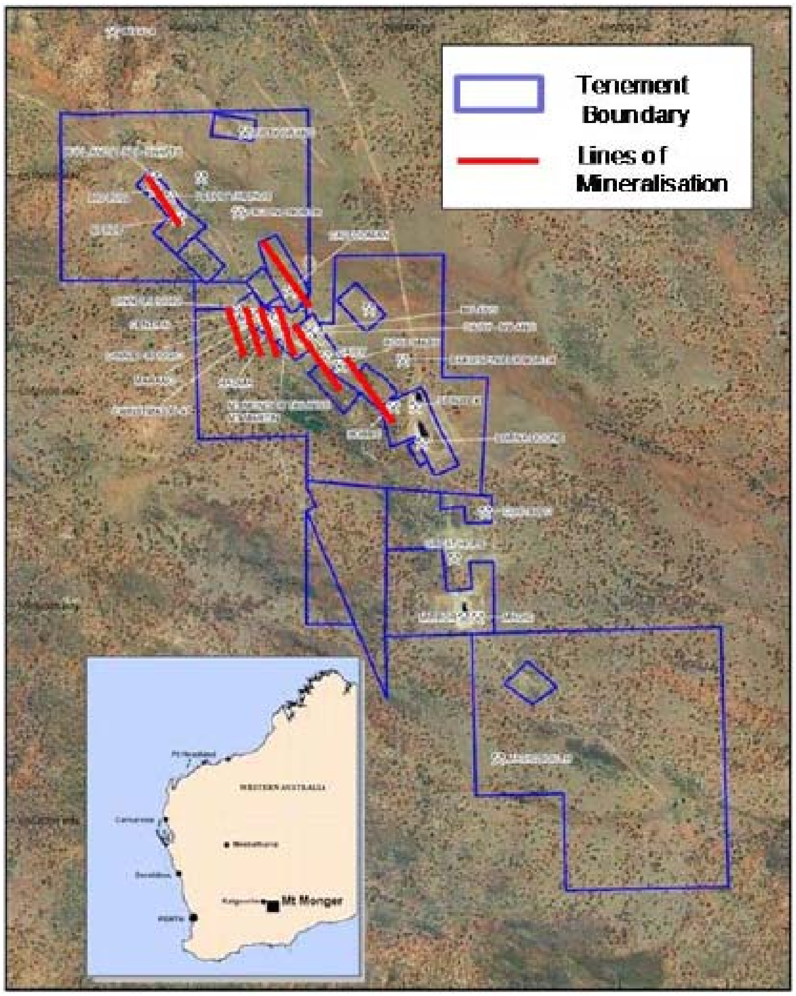
- Production of 10-15koz gold by 30 June 2008;
- Ramp up gold production to 35-40kozpa rate by July 2008; and
- Achieve a cash operating cost of A$450/oz to A$490/oz, once production is at this rate.

Mount Monger has multi mine potential with the Lorna Doone and Costello open cut deposits presently being assessed for mining - a decision is expected in the December quarter. The Caledonian trend also shows potential as a near term underground production source.

On 31 January 2008, Silver Lake commenced a $9.2m, three year exploration programme at Mount Monger, targeting 2Moz in resources across the area. SLR is the first company to undertake a comprehensive, systematic exploration programme over the entire Mount Monger tenement package acquired in November 2007.

The first RC drilling programme has included sixteen holes to a depth of 300m along the Caledonian trend, just 200m from the Daisy Milano mine. SLR was attracted to begin at the Caledonian trend by the presence of historical workings down to just 40m depth and complemented by previous drilling results of 3.0m at 9.3 g/t Au and 4.0m at 7.23 g/t Au.

Silver Lake's Mount Monger Tenements



Murchison Goldfield

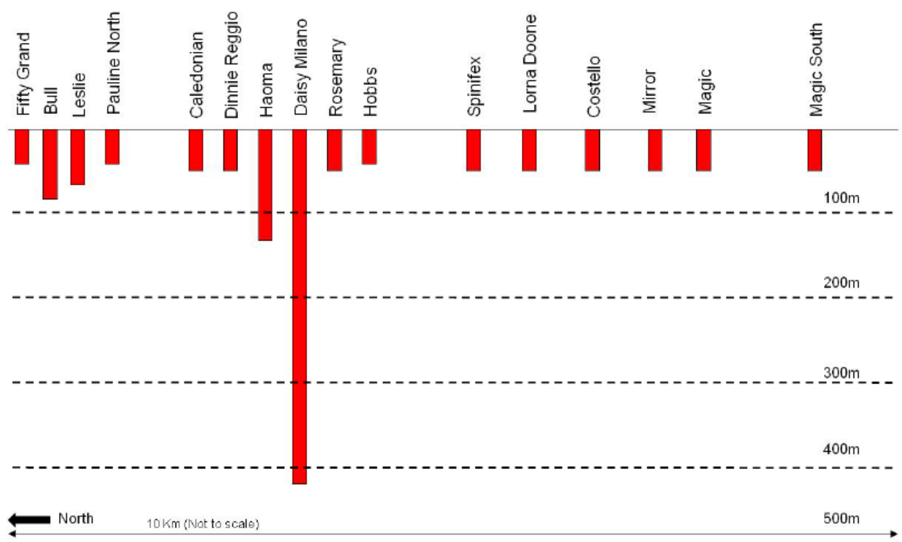
In addition to the Mount Monger Goldfield, **a pre-feasibility study has been commissioned to develop Silver Lake's second multi-mine production centre in the Murchison Goldfield** (includes Tuckabianna, Comet, Moyage and Rothsay Projects). Total estimated resources (excluding Rothsay) are currently 4.9mt at 4.42g/t (693koz contained gold). The study, which is particularly examining milling options - is expected to be completed in the December 2008 quarter. We assume these projects have nil value in our base case valuation (other than the value of the exploration/evaluation expenditure). However, the Murchison Goldfield could deliver material value - Silver Lake is targeting 3Moz in gold resources at the Murchison Goldfield with a planned $5.7m exploration programme.

Valuation

<u>Our base case valuation for SLR is $0.60 per share (fully diluted, allowing for 26m unlisted options), based on: a Mount Monger mine life to the end 2013FY (at 50-70kozpa); excluding any value for the Murchison Goldfield; using a 5% discount rate ($0.53 per share at a 10% discount rate); and our gold price assumptions (an average US$940/oz in the December half 2008 declining to US$775/oz in the December half 2011).</u>

<u>There are currently a number of uncertainties in our model parameters.</u> Total resources at the Mount Monger Goldfield (reported 10 April 2008) are 456kt at 18.7g/t (274koz contained gold). There is substantial upside to this estimate.

Multi Mine Operation & Potential at Depth



Historic Mined Grade	
Daisy Main	28.4 g/t
Milano (Upper)	33.8 g/t
Milano (Lower)	15.6 g/t
Rosemary	27.4 g/t
Haoma	28.9 g/t
Dinnie Reggio	32.6 g/t
Caledonian	7.9 g/t
Pauline	11.8 g/t
Leslie	21.8 g/t
Bull	28.6 g/t
Average	**23.7 g/t**

Source: Silver Lake Resources

SLR has access to a very large drilling data base for the Mount Monger Goldfield, yet only 3% of drillholes extend deeper than 100m. A due diligence report (AngloGold, 2003) had indicated a potential gold inventory of 2.0to 4.5Moz. As stated previously, SLR commenced its fully funded exploration programme at Mount Monger in January 2008 (SLR cash at 31 March 2008: $8m; nil debt) and **is targeting 2Moz in resources**. Further resource upgrades will be forthcoming during 2008.

At this stage there is some uncertainty on realized mined grades at Daisy Milano. SLR believes 15g/t is achievable (which we assume; possible range: 12-20g/t), based on selective mining with minimal dilution (up to 2m widths; Perilya's mine grade was 8-10g/t based on mining widths up to 5m). Tonnage and grade reconciliations should be available in around six weeks and should allow a greater certainty on mine grade estimates.

On our base case assumptions, the Lakewood mill capacity would be underutilized 2009-2013. <u>If the mill operated at capacity (requires exploration success), our valuation (using a 5% discount rate) would increase to around $0.80 per share.</u>

<u>Additionally, assuming a modest valuation for SLR's Murchison Goldfield interests (at A$50/oz), an upside valuation for SLR would be around $1.00 per share.</u>

Valuation at 31/3/08	A$m	NPV/share
Mount Monger Gold Mine [1]	97	0.54
Net Cash	8	0.04
Capitalised Corporate Costs	-6	-0.03
Exploration - Additional Value [2]	4	0.02
Lakewood Plant - Residual Value	5	0.03
Base Case Valuation	**108**	**0.60**
Murchison Goldfield	35	0.19
Upside Valuation	143	0.80

[1] Assumes 320koz of mineable reserves (total 5 year mine life)

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

What's Changed from Previous Ownership (most recently, Perilya Ltd)

Factor	Previous	Current
Ownership	Multiple owners	Consolidated gold field
Operations	Single mine focus	Multiple surface and underground mines
Geology	Mine / tenement specific	Field wide analysis, improved interpretation and structural study
Underground Mining	Bulk mining - dilution	Selective mining on multiple structures - minimal dilution
Workforce	70	35
Processing	Batch toll treating	Owner operator
Exploration	Limited - 3% holes >100 m	Fully funded and field wide

Source: Silver Lake Resources

Mount Monger GoldField		2008	2009	2010	2011
Daisy-Milano	mt	0.021	0.080	0.080	0.080
	g/tAu	15.0	15.0	15.0	15.0
Haoma or Caledonian	mt			0.080	0.080
	g/tAu			10.0	10.0
Lorna Doone & Costello	mt		0.100	0.090	
	g/tAu		3.8	3.5	
Total Ore Milled	mt	0.021	0.180	0.250	0.160
Recovery		98.0%	97.0%	97.0%	98.0%
Gold Production	**koz**	**9.9**	**49.3**	**72.2**	**63.0**
Gold Price	$US/oz	832	915	850	810
	$A/oz	933	973	950	982
Cash costs excl royalties	$A/oz	465	438	419	381
Cash costs incl royalties	$A/oz	489	463	443	405
Total costs excl royalties	$A/oz	785	515	488	476
Total costs incl royalties	$A/oz	808	539	512	501

Profit / (Loss) $Am	2008	2009	2010	2011
Revenue	9.3	48.0	68.6	61.9
Mining, Transport, Admin	-4.0	-16.6	-23.3	-19.5
Milling	-0.6	-5.0	-7.0	-4.5
Operating Surplus	4.6	26.4	38.3	37.9
WA State Gov. Royalty	-0.2	-1.2	-1.7	-1.5
Depreciation/amort	-3.2	-3.8	-5.0	-6.0
Other	-0.8	-1.0	-1.0	-1.0
Pre-tax profit	0.4	20.4	30.6	29.3
Tax expense	0.0	-5.2	-8.7	-8.6
Adjusted Profit	**0.4**	**15.2**	**21.9**	**20.7**

Cash Flow $Am	2008	2009	2010	2011
Operating Surplus	4.6	26.4	38.3	37.9
Capital Expenditure	-19.0	-3.0	-5.0	-3.0
WA State Govt Royalty	-0.2	-1.2	-1.7	-1.5
Exploration/evaluation expenditure [1]	-2.0	-6.2	-4.5	-2.2
Tax Paid	0.0	-5.2	-8.7	-8.6
Net Cash Flow	**-16.6**	**10.7**	**18.4**	**22.5**

[1] Includes planned $5.7m Murchison expenditures - excluded from base case valuation.