



Medusa Mining Limited (MML-ASX A\$4.21)

Mining & Minerals

Initiating Coverage – Excellent Upside for Rapidly Growing Filipino Producer

Recommendation BUY
Target A\$5.00
Return 18.8%

COMPANY DATA

Shares Outstanding (mill)	168.8			
Market Capitalization (mill)	A\$710.6			
Net Debt (mill)	(A\$29.3)			
Enterprise Value (mill)	U\$630.1			
52-Week Range	A\$0.41 - A\$4.05			

YE Jun 30	2008	2009	2010e	2011e
Gold Production (oz)	19,009	47,869	86,543	104,950
Total Cash Costs (US\$/oz)	U\$248	U\$213	U\$197	U\$203
Revenue (mill)	A\$17.6	A\$57.0	A\$93.1	A\$112.8
EBITDA (mill)	A\$4.6	A\$40.4	A\$54.7	A\$64.5
Net Earnings (mill)	(A\$1.3)	A\$38.1	A\$48.2	A\$59.0
per share	(A\$0.01)	A\$0.25	A\$0.25	A\$0.34
Oper. Cash Flow (mill)	A\$7.2	A\$39.7	A\$55.7	A\$67.2
per share	A\$0.05	A\$0.24	A\$0.33	A\$0.39
Price/Cash Flow	84.8x	17.9x	12.9x	10.8x

KEY PERSONNEL

Managing Director	Geoffrey Davis
Finance Director	Roy Daniel

- **Goal to become 300-400,000 oz/yr gold producer.**
Management is on track for 86,000 oz this year, rising to 100,000 oz; second project could then triple annual output.
- **Very low cost at US\$193/oz protects downside.**
FQ1/10 reported at 18,054 oz at US\$193/oz - making it one of the world's lowest cost gold producers.
- **CFPS rises 16% for every 10% change in gold.**
Applying normalized market multiple of 14.0x to CFPS chg (A\$0.05) implies a potential A\$0.72 move in share price.
- **Recommended as Buy with Target of A\$5.00/sh.**
Trading at discount to peers on P/CF (12.9x P/10e versus 16.3x); target based on 1.3x P/NAV of A\$3.89 per share.

Annual General Meeting Nov 18th in Perth, Australia.



Source: Capital IQ

Company Profile

Medusa Mining operates the Co-O high-grade, underground gold mine in the southern Philippines. The expansion of the low-cost mine is targeted for 100,000 oz next year from 47,869 oz at US\$213/oz produced in FY2009. Large land package along the East Mindanao Ridge, also hosts the advanced Bananghilig gold project, which could triple the company's annual gold production in coming years. Regional exploration has targeted copper porphyry deposits (Lingig) as well as vein and disseminated gold deposits. Well-financed, with no long-term debt. www.medusamining.co.au.

Investment Summary

Growing low cost gold producer. Medusa Mining is an Australian mining company that has operated the Co-O high-grade, underground gold mine in the Mindanao area of the southern Philippines for the last three years. The operation is one of the world's lowest cost mines due partly to the favourable infrastructure and low country costs. The mine and mill are nearing the completion of an expansion to 1,000 tpd capacity to recover 100,000 oz/year. Exploration potential is excellent on the 820 sq km land package, with a well-financed and growing pipeline of projects. The Bananghlig gold project has the potential to triple annual output within the next few years and the well-located Lingig copper project is being systematically advanced.

Pending newsflow. Nine drill rigs are active at the Co-O mine, including three underground for development drilling. A further three rigs are drill-testing nearby veins (Figure 8). Results from about 40-50 new holes in and around the mine are expected within the next few weeks. The program is expected to lead to an updated reserve and resource estimation in early January, which is anticipated to increase reserves at the Co-O mine and expand resources. The company is listed on the ASX and AIM exchanges, and we believe the time is right to broaden shareholdings into North America. The rapid share price rise this year was well-correlated to the gold price, and we believe the shares offer good fundamental growth as global gold demand continues to be strong.

Figure 1: Medusa Mining - Resource Summary

Mine/Project	Proven/Probable Reserves			Meas/Indic Resource			Inferred Resource		
	(000 t)	(g/t)	(000 oz)	(000 t)	(g/t)	(000 oz)	(000 t)	(g/t)	(000 oz)
Co-O	1,041	14.90	500	1,250	15.00	603	2,730	8.90	777
Bananghlig	-	-	-	-	-	-	15,000	1.30	650
TOTAL	1,041	14.90	500	1,250	15.00	603	17,730	8.90	1,427

Source: Medusa Mining.

Valuation Summary

Recommended as Buy with a target price of A\$5.00 per share. Based on strong cash flow generation, no debt and excellent exploration upside, a 1.3x market multiple is applied to the estimated net asset value of A\$3.89 per share, to determine the target price of A\$5.00 per share. Good gold price sensitivity (15% change in cash flow per share with every 10% change in the gold price) in the current strong market is favourable for additional upside, while the low cash cost base is good support for the shares on the downside. Resource expansion is anticipated which should lead to further production growth in coming years.

Strong cash flow generation and gold price sensitivity. Medusa Mining shares are currently trading at 12.9x FY2010 cash flow of A\$0.33 per share. This compares to peer companies now at 16.3x, well above the high end of the normalized 12-14x range. Based on FY2010e cash flow, Medusa shares could trade at a normalized A\$3.91-\$4.56 per share, and taking one year forward, using the twelve months ended June 30, 2011, the shares could trade at A\$4.70-\$5.48 per share.

Net asset valuation returns A\$3.89 per share. The net present value estimated for the Co-O mine is based on US\$1,000/oz gold, rising production and steady costs (financial summary Figure 13). The Bananghlig project has the potential to double the resource to 1.3 million oz, valued herein at US\$50/oz or A\$67.8 million or A\$0.39 per share. The Lingig copper project is generally valued based on costs expended to-date and is expected to increase in value in the coming year with as the project is advanced and an initial resource is released. Adding working capital of A\$0.19 per share, indicates a total net asset value of A\$667.2 million or A\$3.89 per share. In line with North American peer companies which trade at 1.25-1.50x P/NAV, we have applied a modest 1.3x valuation to return a target price of **A\$5.00 per share**.

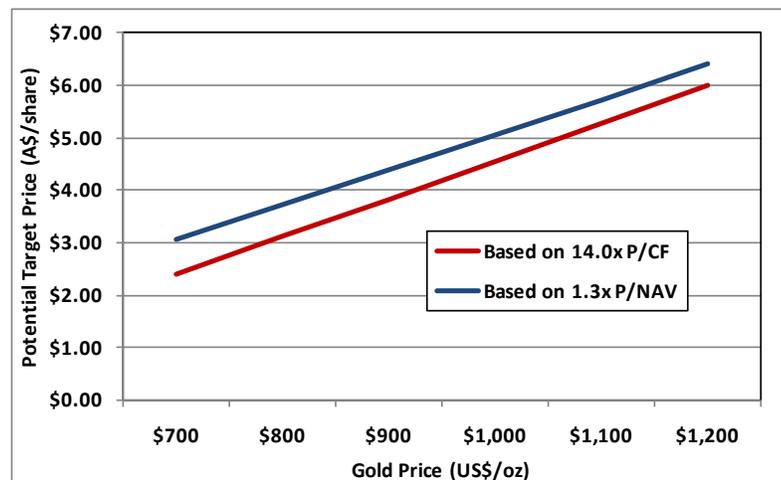
Figure 2: Valuation Summary

	Potential Market Value	
	A\$ 000	A\$/sh
Co-O Mine (NPV 3%)	\$540,457	\$3.15
Bananghlig Gold Project	\$67,751	\$0.39
Lingig Copper Project	\$26,058	\$0.15
Working Capital	<u>\$32,939</u>	<u>\$0.19</u>
Total Net Asset Value	\$667,204	\$3.89

Source: Sandfire Securities Inc

Gold price sensitivity. For every 10% change in the modeled gold price of US\$1,000/oz, cash flow per share changes by 15.9% or A\$0.05 per share. Applying a 14.0x multiple to determine a normalized target price, implies a share price change of A\$0.72 for every 10% change in the gold price. Likewise, if the modeled gold price changes by 10%, the estimated net asset value changes by 13.2%, and the potential target price at 1.3x P/NAV, changes by A\$0.67 per share. This is shown graphically in Figure 3.

Figure 3: Gold Price Sensitivity



Source: Sandfire Securities Inc

Cost and growth vs peers. Selected comparable producers and advanced development companies' reserves (oz and grade), resources, commercial production and targets and valuation comparisons are shown in Figure 3. We believe Medusa Mining shares stand out due to the company being on track for positive annual production growth, at the lowest total cash costs of its peers. The relatively low reserve base is common for high-grade underground operations. We anticipate a reserve and resource increase when Medusa reports in early January, in line with timing for North American reserve and resource annual reporting.

Figure 4: Selected Comparable Companies

	Symbol	Price (C\$)	Shares (000)	Market Capital. (C\$000)	EV (US\$000)	Prv/Prb Reserves		Meas/Indic Resource (000 Oz)	Inferred Resource (000 Oz)	EV/oz	
						(000 Oz)	(g/t)			Reserve	Minlzn*
Allied Nevada Gold	ANV-T	\$12.79	71,263	\$855,159	\$757,535	1,143	0.55	8,177	7,497	\$663	\$49
Andean Resources (AU)	AND-T	\$2.57	461,346	\$1,139,525	\$1,051,700	1,472	6.40	296	235	\$714	\$538
Aurizon Mines	ARZ-T	\$5.20	158,938	\$799,457	\$704,899	956	7.80	2,402	2,060	\$737	\$141
C GA Mining (AU)	CGA-T	\$1.82	283,988	\$496,979	\$575,277	3,032	1.02	43	2,940	\$190	\$106
Kirkland Lake Gold	KGI-T	\$9.70	63,119	\$569,332	\$561,482	1,332	18.79	1,008	822	\$422	\$187
Lake Shore Gold	LSG-T	\$4.10	213,359	\$646,476	\$760,317	826	7.59	403	703	\$920	\$425
Medusa Mining	MML-A	\$4.21	168,692	\$678,142	\$665,380	500	14.90	603	1,427	\$1,331	\$296
Minefinders Corp.	MFL-T	\$11.14	66,317	\$696,329	\$730,051	2,444	0.77	3,498	708	\$299	\$112
Perseus Mining (AU)	PRU-A	\$1.71	357,962	\$662,230	\$550,904	2,141	1.20	1,031	2,132	\$257	\$113
San Gold Corp.	SGR-V	\$3.27	265,496	\$804,453	\$796,987	334	8.90	69	1,198	\$2,388	\$586
Average:					\$715,453						

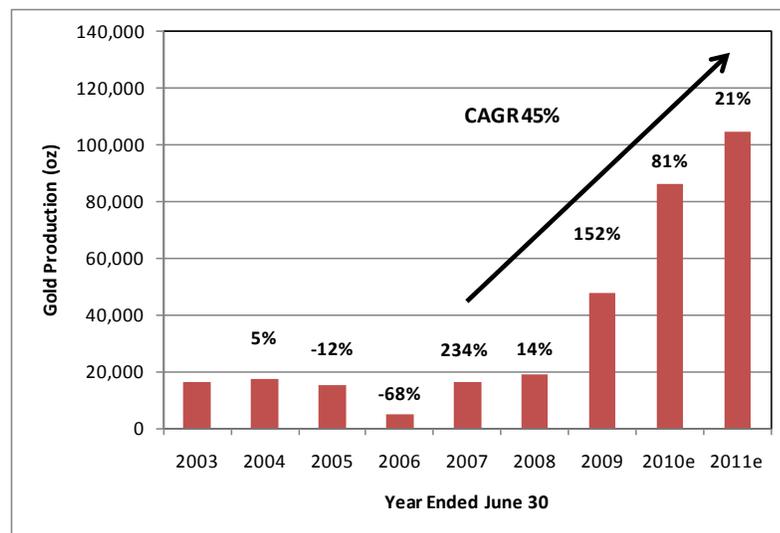
	Production (000 oz)			Costs (US\$/oz)		CFPS		P/CF		Location
	2008	2009e	2010e	2009e	2010e	2010e	2011e	2010e	2011e	
Allied Nevada Gold	-	48	100	\$450	\$455	\$0.73	\$0.95	17.5 x	13.4 x	Nevada
Andean Resources (AU)	-	-	-	-	-	NA	NA	NA	NA	Argentina
Aurizon Mines	159	153	161	\$415	\$410	\$0.46	\$0.56	11.2 x	9.4 x	Quebec
C GA Mining (AU)	13	200	200	\$250	\$250	\$0.47	\$0.46	3.9 x	4.0 x	Philippines
Kirkland Lake Gold	40	95	139	\$513	\$392	\$0.50	\$1.10	19.5 x	8.9 x	Ontario
Lake Shore Gold	-	-	-	-	-	\$0.10	\$0.34	42.7 x	12.1 x	Ontario
Medusa Mining	48	87	105	\$197	\$203	\$0.33	\$0.39	12.9 x	10.8 x	Philippines
Minefinders Corp.	10	128	170	\$468	\$460	\$1.09	\$1.47	10.2 x	7.6 x	Mexico
Perseus Mining (AU)	-	-	-	-	-	NA	NA	NA	NA	Ghana
San Gold Corp.	12	70	109	\$467	\$378	\$0.27	\$0.43	12.2 x	7.6 x	Manitoba
Average:								16.3 x	9.2 x	

Source: Company Reports, Sandfire Securities Inc. * Mineralized material = measured + indicated + 80% inferred resource.

Co-O Gold Mine, Philippines

Production growth on track for low-cost underground gold mine. Medusa Mining acquired the Co-O mine from Philsaga Corporation in December 2006 and is successfully expanding the operation. The mine and mill are being expanded in two phases to a 1,000 tpd capacity. Phase 1 is complete, bringing throughput to 400 tpd or 60,000 oz/yr gold output rate. Phase 2 is targeted for completion by the end of March 2010, taking annual output to 100,000 oz. Production in the fiscal year ended June 30th totaled 49,869 oz at total cash costs of US\$213/oz. This compares to 19,009 oz at total costs of US\$248/oz in the preceding fiscal year. The compound annual growth rate of 45% is remarkable compared to many emerging global gold producers.

Figure 5: Co-O Mine Annual Gold Production



Source: Medusa Mining, Sandfire Securities Inc.

Twenty-five year mining licence. The mine property is located on the East Mindanao Ridge, an 80-km long trend of precious and base metal mines and deposits in the Philippines. Road access is excellent, about a 2.5 hour drive on paved highway from the city of Davao. Infrastructure is good, with local gravel roads, access to grid power supported by back-up generators and ample water. Machine shops are located at site, along with a warehouse, camp accommodation, geological offices, core storage and administrative offices.

Prolific large, high-grade vein system. The Co-O underground mine has surface access from a portal and several inclined shafts, with all ore hoisted to surface. The consistent veins are known to extend across an area 1.4 km in length and 500 metres in width. Underground development occurs through the high-grade veins with very little development in waste material. The Great Hamish and Jereme veins are the most continuous across the property and widest (five metres), but narrower veins at higher grades are also economic. In contrast to the high-grade vein systems in the Canadian Abitibi region, there is no visible gold, thus security is not an issue at the mine. Mining costs averaged about \$37/tonne in the fiscal year ended June 30th. Reserves total 500,000 oz grading 14.9 g/t, sufficient for five years of mine life at full production. Resources add another 1.38 million oz. Current reserves and resources cover only the strike of the existing mine workings (about 600 metres).

Figure 6: Property Holdings Along East Mindanao Ridge

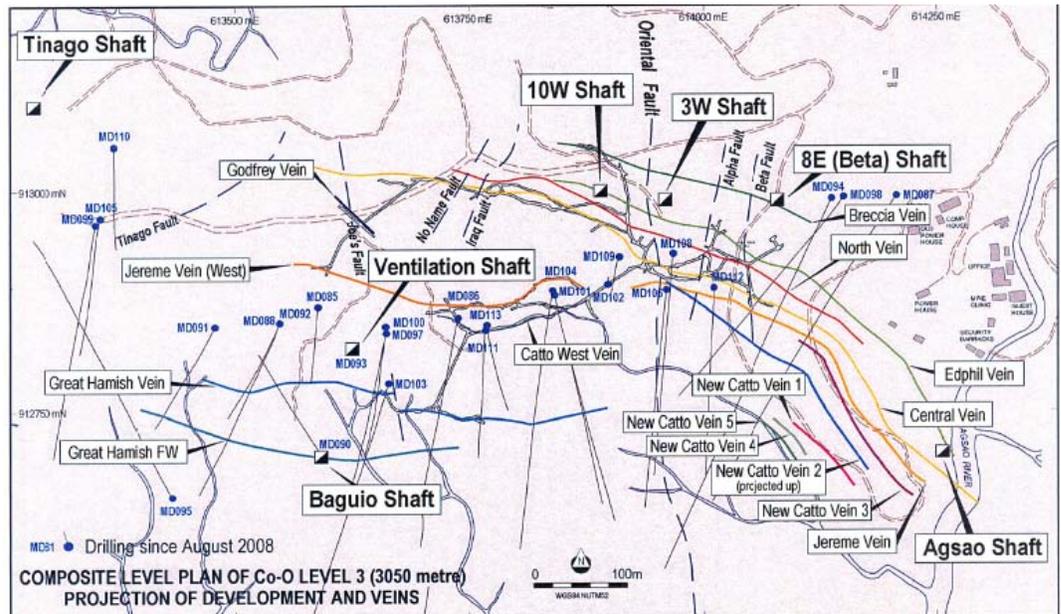


Source: Medusa Mining.

Current development program. The Phase 2 expansion program involved the sinking of the new Baguio shaft 240 metres deep to Level 3. This now provides faster access to the current main level, where stope development is underway into the Great Hamish and Jereme veins, and development is heading to the south towards the Great Hamish Footwall Vein. Level 3 is being extended to the northwest where the veins have been identified by drilling at depth. In the late 1980's initial development at the mine was in the northern area, west of the Oriental Fault, where some of the veins were exposed at surface. It was later discovered that the north-south Oriental fault down-dropped the veins by about 300 metres and displaced them by about 30 metres, on the east side of the fault.

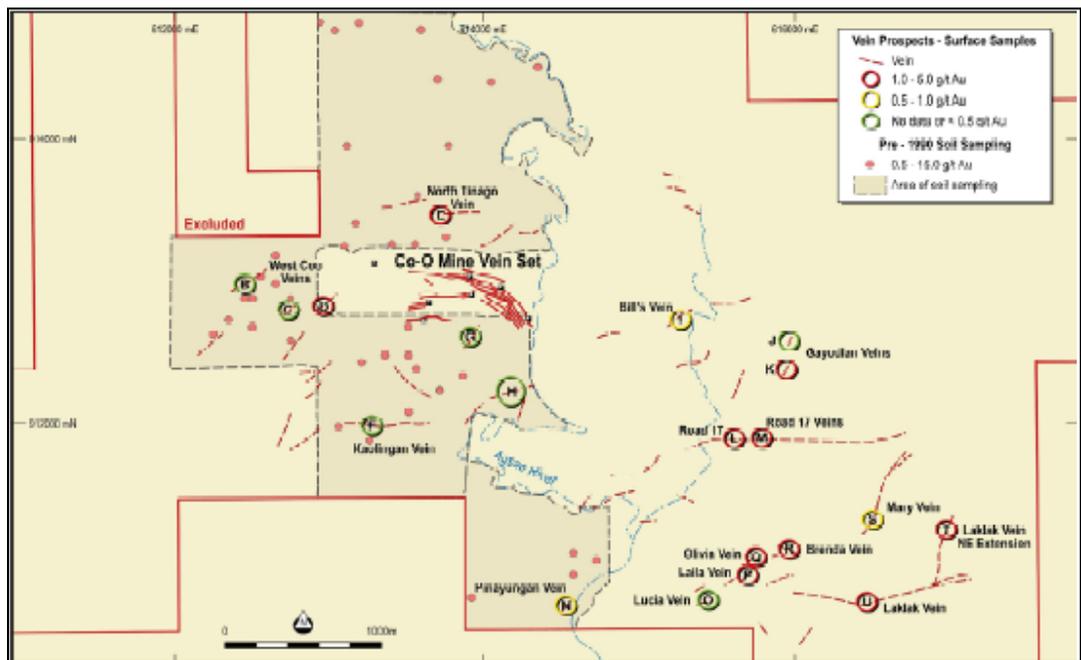
Development plans for expansion at depth and along strike. The current five levels of the mine are 50 metres apart to 370 metres depth, with plans to commence Level 6 next year. The continuity and grade of the veins suggests development at depth is limited only by the time and cost of constructing supporting infrastructure. The veins are also continuous in a lateral direction. The Great Hamish vein has been drilled at least 130 metres to the west and about 800 metres further to the east. The sinking of a vertical winze to the east across the river is under review. The exact location will be partly dependent on the next update of reserves and resources, anticipated January 2010. An upgrading of resources to reserves is anticipated, as well as an expansion of the overall resource. We believe the five-year mine plan at full production can be extended to at least fourteen years.

Figure 7: Co-O Mine Plan View of Level 3 Showing Shafts, Veins and Recent Drilling



Source: Medusa Mining.

Figure 8: Exploration Upside in Co-O Mine Area Showing Nearby Identified Veins

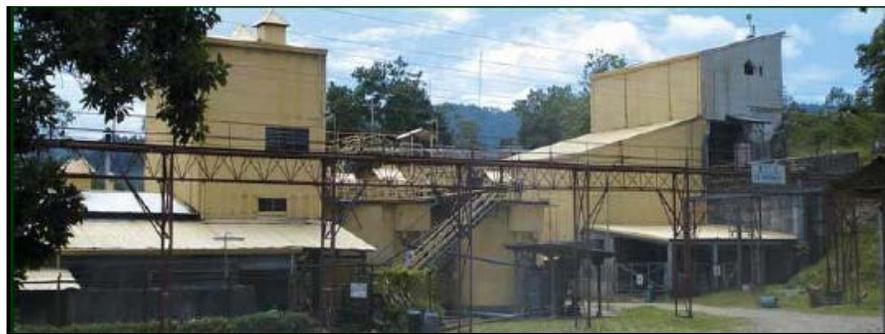


Source: Medusa Mining.

Processing

Ore is trucked about 12 km from the mine to the mill, which was built in 1988 by BHP Billiton originally at 500 tpd. Material is passed through a crusher, primary ball mill, two SAG mills and a carbon-in-pulp circuit. Average ore recovery is steady at 93%, due to a consistent feed of ore, with no deleterious elements, grading on average about 13 g/t gold. Construction is underway to expand the crushing and leach circuits. This includes two fine ore bins fabricated on site and installation of a second ball mill. Capacity is targeted to increase to 1,000 tpd by late 2009. Processing costs averaged \$47/tonne in the fiscal year ended June 30, 2009. There is an independently verified assay lab on site. A new two-year tailings dam is completed, with a larger, eight-year capacity dam anticipated to be constructed by early 2010.

Figure 9: Adminstrative Office and Processing Plant Before and During Construction





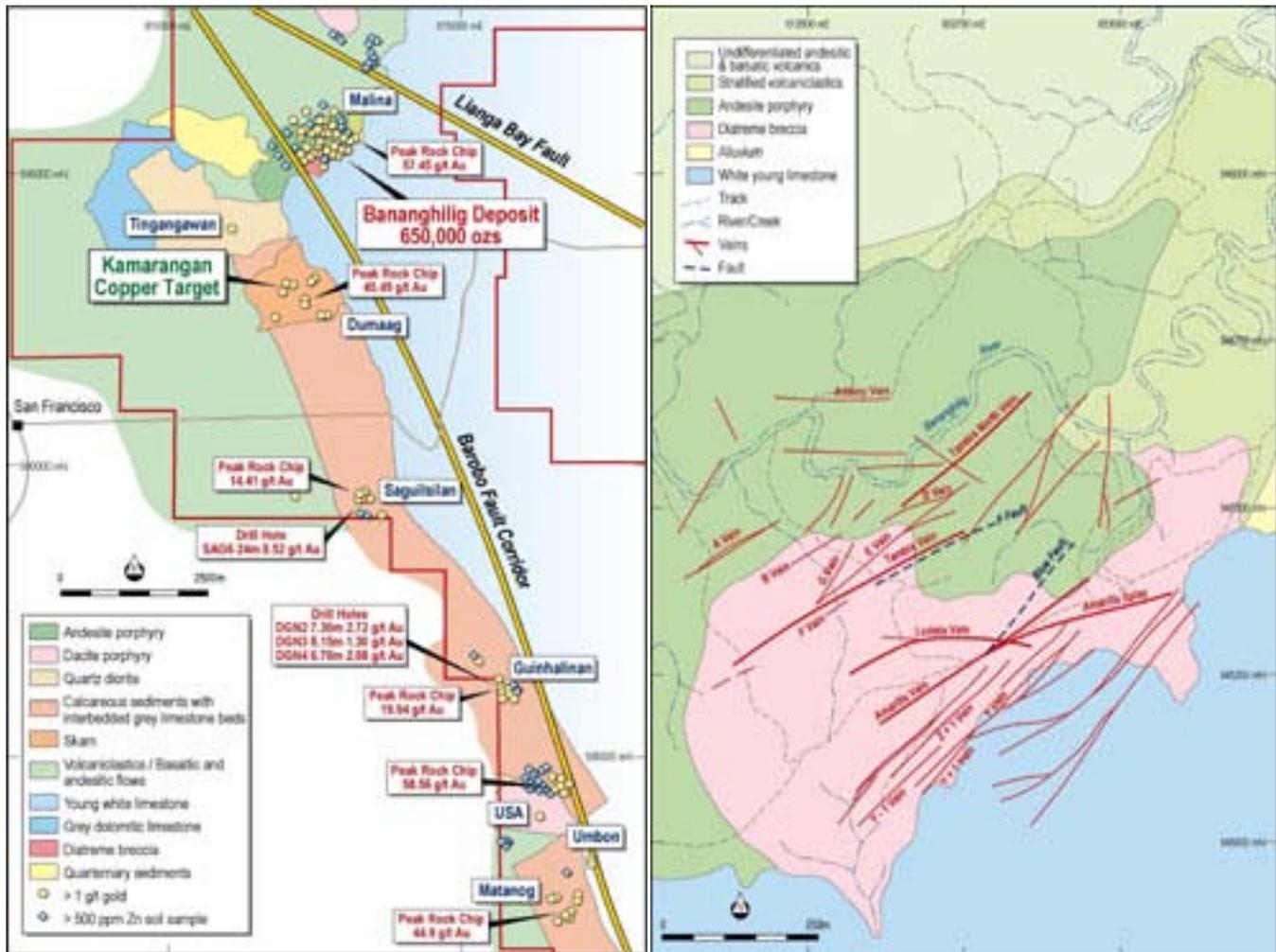
Source: Medusa Mining.

Banaghilig Gold Project, Philippines

Barobo Fault Corridor - 18 km gold and copper mineralized trend. Located about 30 km north of the Co-O mine, the Banaghilig project hosts 650,000 oz gold in inferred resource grading 1.3 g/t gold. This initial resource was released in August 2009, at a cut-off grade of 0.6 g/t gold. The deposit is at the northern end, on the east side of the Barobo Fault Corridor, an 18 km-long regional trend of gold and copper mineralization. A structural association to mineralization is likely, with the Banaghilig deposit located just south of the intersection of the Barobo Fault with the Lianga Bay Fault. The early-stage Kamarangan copper project is just south of Banaghilig, and along the corridor, numerous showings, chip samples and limited drilling indicate the prospectivity of the mineralized trend. A large, systematic regional exploration program appears justified.

Potential to be Medusa' second gold mine. The shallow disseminated Banaghilig gold deposit could be mined by open pit. Assuming a 15,000 tpd mining rate, the deposit could produce about 200,000 oz per year, thus tripling Medusa's annual production level. The deposit has been drill-tested along an 850 m strike length, a width of 550 m, to depths of about 150 m, and remains open. Drill intersections returned have included 205.9 m at 2.42 g/t, 182.0 m at 2.13 g/t, 116.5 m at 3.96 g/t and 64.0 m at 8.4 g/t. Follow-up drilling to expand the resources and preliminary engineering studies are underway.

Figure 10: Bananghilig Gold Project within the Barobo Fault Corridor and Interpreted Geology

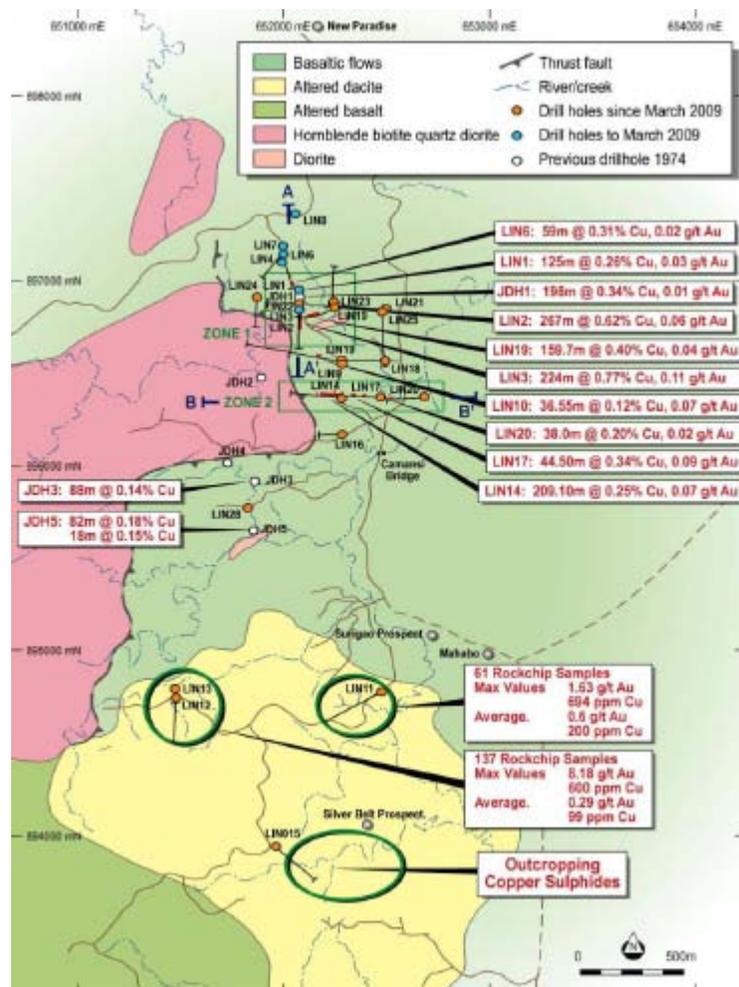


Source: Medusa Mining Limited.

Lingig Copper/Gold Project, Philippines

Three drill rigs active; 150 km from deep-sea port. The Lingig copper project is located on the eastern-most tenement, southeast of the Co-O mine. Extensive regional mapping, geochemical and geophysical surveys have been completed across the area. Drilling this year totals 6,400 m in 17 holes and has returned extensive intersections of copper associated with a 200-300-metre-thick east-dipping, thrust zone. Results included 198.0 m at 0.34% copper, 267.3 m at 0.62%, 224.0 m at 0.77% and 159.7 m at 0.40%. Mineralization is structurally related and requires further drill-testing. Mineralized porphyry rocks have been intersected at the bottom of some of the drill holes 400 m to the south, but the volcanic source has not yet been defined. The current drilling program uses three rigs and is anticipated to culminate in an initial resource estimate in the coming year. The opportunity at Liingig is location. If exploration continues to be encouraging, potential production of a copper-rich concentrate could be cost-effective due to the proximity of a deep-sea port for shipping to markets. Based on Medusa Mining’s focus on gold mining, it is possible the Lingig project is optioned, joint ventured or sold to a third party.

Figure 11: Lingig Project: Geological Map Showing Selected Drill Intercepts



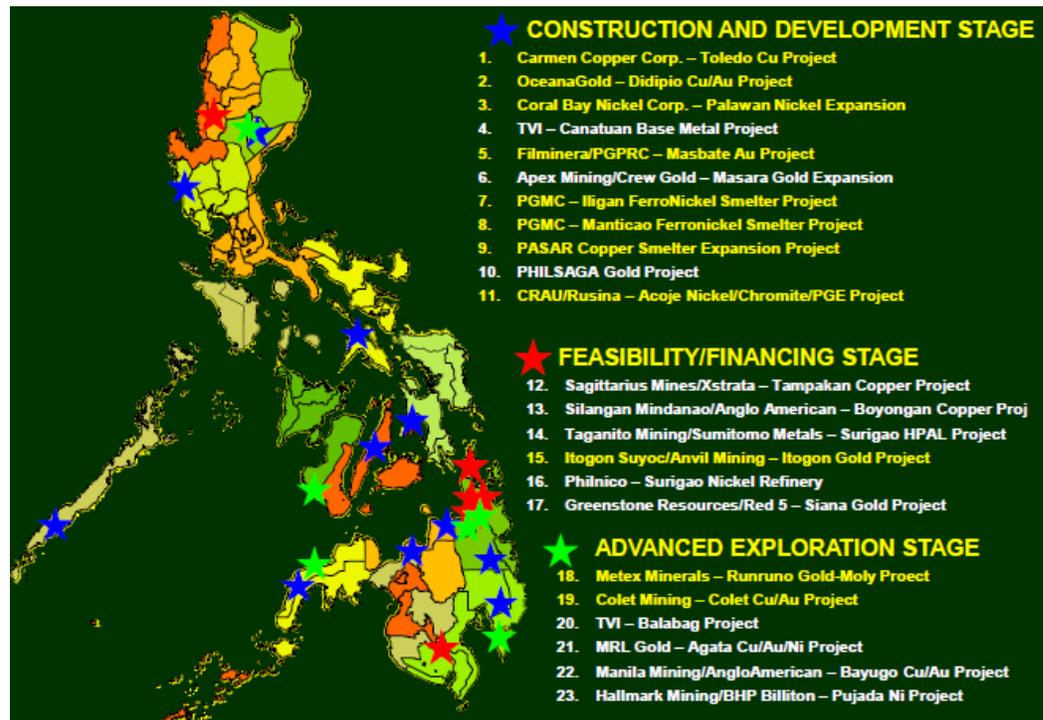
Source: Medusa Mining Limited.

Philippines

Mining-friendly and prospective. From 2004-2014, an estimated \$14 billion is expected to be invested in the mining sector. The Philippines government projects \$2 billion for 2010, up from \$600 million in 2009 and \$650 million in 2008. Favourable mining tax treatments are available for new projects, but the government is most focused on improving environmental compliance and protection, reducing processing times for mining permits and cancelling non-active mining claims to stimulate foreign investment and revitalize the mining industry.

Mining since the 1930's. The 1,200 km-long Philippine Rift Fault and subduction zone which trends north-south through the Philippines islands, hosts copper porphyries, epithermal gold veins, skarn and disseminated gold deposits. The country's long mining history has resulted in numerous gold, copper and nickel mines and projects. Some currently active mines/projects include Tampakan copper (Xstrata), HPAL nickel (Sumitomo), Boyongan copper/gold (Philex Mining), Masbate (CGA Mining), Toldeo copper (Carmen Copper), and numerous other advanced projects, mine re-openings and expansions.

Figure 12: Map of Philippines Showing Regional Structural Faults and Selected Mines/Projects



Source: Mines and Geoscience Bureau, Dpt. Of Environment & Natural Resources, Philippines.

Excellent social and community programs. Medusa Mining appears to have an excellent relationship with the local communities, likely due to the consistent involvement and support of Philsaga Mining and its President, Samuel Afdal. The workforce at the mine is 99% Filipino, with a large majority living on the mine property with their families. New homes and community buildings have been built by the Company. Schools, day cares, scholarships and educational assistance have been provided. A medical clinic is complemented by a hospital on the mine site, staffed by a full-time doctor. Financial assistance with loans to rice farmers is another sustainable project that the Company has supported.

Corporate and Financial

Independent, well-financed, low-cost producer. Medusa Mining acquired the Co-O mine in December 2006 from Philsaga Mining. Co-founders Samuel Afdal and Bill Phillips remain board members of Medusa and important local managers of the operation. Bill Phillips is in charge of mine operations and Samuel is instrumental with social and government relations in the country. Medusa is listed on the ASX and AIM exchanges and is included in the S&P ASX 200 Index. Working capital is about \$30 million with no long-term debt. Major shareholders include officers and directors (15.1%), Rex Harbour & Associates (12.3%) and Metalloinvest Holdings (10.5%). Limited shares are held in North America.

Management and Board of Directors

- Geoffrey Davis** **Managing Director, Director (2002).** Geologist with over 35 years of global exploration, evaluation and mining experience, including a focus in the Philippines since 1980, as well as the Co-O property holdings.
- Roy Daniel** **Finance Director, Company Secretary, Director (2006).** Over 25 years of global resource and financial experience.
- Samuel Afdal** **President Philsaga Mining.** Co-founder of Philsaga Mining; closely involved with community and government relations.
- Bill Phillips** **Operations Director Philsaga.** Co-founder of Philsaga Mining; over 30 years global contracting and mining experience, including a focus in Western Australia, as well as with narrow vein, underground mines. Director of Kingsrose Mining.
- Peter Alphonso** **Joint Company Secretary.** Over 29 years experience in financial accounting and statutory reporting, including positions with Western Mining, Great Central Mines and Ti West joint venture.
- Kevin Tomlinson** **Non-Executive Chairman (2005).** Managing Director for Thomas Weisel Partners UK. Over 27 years of global mining and investment banking experience.
- Dr. Robert Weinberg** **Non-Executive Director (2006).** Over 30 years experience in the global mining and investment industries. Previously held senior positions with the World Gold Council, Deutsche Bank, SG Warburg Securities, Societe Generale, James Capel, Anglo American. Director of Solomon Gold, Falkland Gold & Minerals, Great Bear Resources and Kasbah Resources.
- Peter Hepburn-Brown** **Non-Executive Director (2009).** Managing Director of Alloy Resources. Over 28 years experience as a mining engineer, holding senior management positions with companies including Harmony Gold Australia and Great Central Mines. Director of Kasbah Resources and Genesis Resources.

Figure 13: Operating and Financial Summary

FY June 30	2008	2009	2010e	2011e
Operations				
Ore Milled (tonnes)	69,834	116,451	216,000	270,000
Gold Grade (g/t)	10.42	13.30	13.40	13.00
Recovery (%)	81%	93%	93%	93%
Gold (Ounces)	19,009	47,869	86,543	104,950
Total Cash Costs (US\$/oz)*	\$248	\$213	\$197	\$203
Est. Realized Gold Price (US\$/oz)	\$685	\$880	\$1,000	\$1,000
Earnings (A\$000)				
Revenue	\$17,630	\$57,018	\$93,057	\$112,849
Operating Costs	(\$10,067)	(\$17,339)	(\$19,742)	(\$24,677)
General & Admin	(\$3,307)	(\$2,352)	(\$4,653)	(\$5,642)
Exploration	(\$572)	(\$81)	(\$14,000)	(\$18,000)
EBITDA	\$4,586	\$40,369	\$54,662	\$64,529
Deprec., Amort.	(\$3,637)	(\$4,789)	(\$7,401)	(\$8,187)
Interest Income/(Expense)	\$69	\$234	\$988	\$2,688
Taxes	(\$2,366)	\$2,291	\$0	\$0
Net Earnings	(\$1,347)	\$38,105	\$48,249	\$59,030
Per Share	(\$0.01)	\$0.25	\$0.25	\$0.34
Cash Flow (A\$000)				
Operating Cash Flow	\$7,200	\$39,719	\$55,651	\$67,217
Per Share	\$0.05	\$0.24	\$0.33	\$0.39
Capital Expenditures	(\$17,044)	(\$35,745)	(\$11,000)	(\$11,000)
Total Investing	(\$14,730)	(\$27,366)	(\$8,500)	(\$8,500)
Borrowing/Repayments	(\$5,069)	\$26,841	\$12,000	\$0
Total Financing	(\$5,069)	\$26,841	\$12,000	\$0
Other	(\$421)	(\$2,710)	\$0	\$0
Net Cash Flow	(\$15,334)	\$28,105	\$56,651	\$56,217
Discount Rate	0%	3%	5%	8%
NPV (A\$000)	\$661,415	\$540,457	\$477,692	\$414,121
Per Share	\$3.85	\$3.15	\$2.78	\$2.41

Source: Company Reports, Sandfire Securities Inc.

Research Disclosure

<i>Issuer</i>	<i>Applicable Disclosures</i>
Medusa Mining Limited (MML-ASX, AIM)	6
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