18 May 2010

# Chaarat Gold

## New High-grade Open Pit Potential

**BUY**

## Mining

| | |
|---|---|
| **Price** | **51.25p** |
| **Target Price** | **82p** |

### Company description

Chaarat Gold is a gold exploration and development company working in the western part of the Kyrgyz Republic.

### Key data

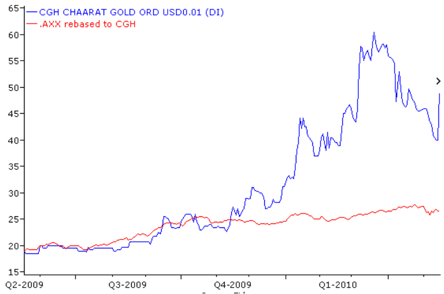
| | |
|---|---|
| Ticker | CGH |
| Listing | AIM |
| No. of shares (m) | 112.91m |
| Market cap (£m) | 57.87 |
| Enterprise value (£m) | 55.10 |

| Top-five shareholders | (% holding) |
|---|---|
| China NonFerrous Metals Int'l Mining Co. Ltd | 19.9 |
| Mada Limited | 10.8 |
| Vetan Investments Limited | 7.9 |
| Chase Nominees Limited | 6.6 |
| Palmer-Tomkinson & Family | 5.5 |

### Relative performance

| **Period:** | **1mn** | **3mn** | **12mn** |
|---|---|---|---|
| Performance (%) | 13.96 | 26.95 | 130.5 |

### Price/AIM All-Share rebased to CGH




*Price source: Fidessa, as of 18/05/2010.*

### Marketing communication

**Westhouse Securities acts as NOMAD and Co-Broker to Chaarat Gold and is paid fees for these services**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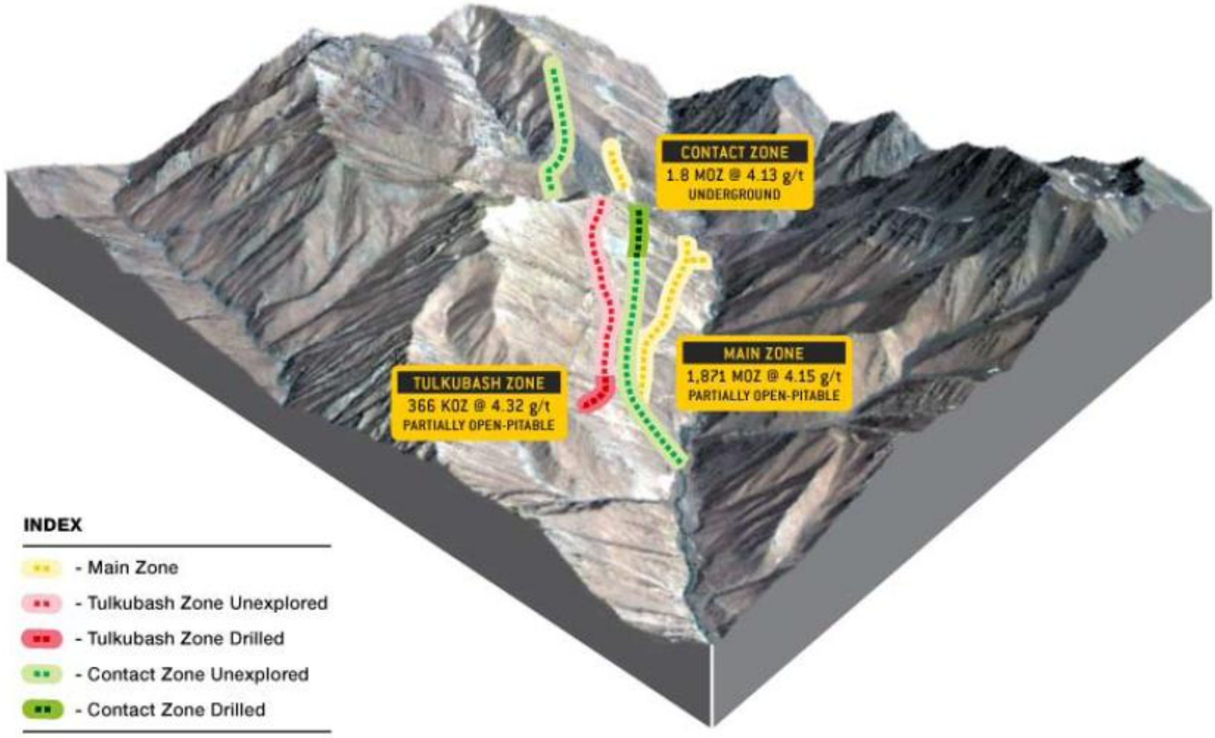
**Chaarat Gold has released an operations update for its wholly owned Chaarat project in the Kyrgyz Republic. The project currently has a JORC compliant resource of 4.009Moz and after a positive scoping study on establishing an underground mine, is on track to complete a pre-feasibility study in Q3 2010. However, Chaarat believes that there is now potential for a high-grade, low-cost open pit mining non-sulphide ore, either as a standalone project or as pre-cursor to the underground. With 336,000 oz at a grade of 4.18 g/t Au, this zone of mineralization has not been extensively drilled and preliminary studies indicate the potential for the resource to be increased considerably. Drilling will recommence this week. No cost information is currently available, so we have not included this in our valuation, but with the strengthening dollar, we maintain our BUY recommendation and increase our target price from 76.5p to 82.0p per share.**

- Current 4.009Moz JORC Gold Resource
- Potential to develop Tulkubash zone as high grade, low cost open pit mine and fast track production and revenue
- Pre-feasibility Study (PFS) expected to be complete Q3 2010
- Revised processing plan could lead to substantial Capex and Operating Cost reductions
- Production of 200,000oz pa expected end of 2012 from Main and Contact Zones
- Support from Chinese major shareholder

## Potential for Initial High-grade low cost Open Pit

In March, Chaarat increased the size of its resources from 3.339Moz to 4.009Moz of gold and stated that the Chaarat mine is likely to be a combined open pit and underground operation. Of the three mineralised zones present both the Main and Tulkubash zones were believed to have at least some open pit potential.

**Schematic representation of the Sandalash Valley showing possible development options for Chaarat**




*Source: Company*

Since then the company has been progressing with the pre-feasibility study due to be completed in Q3 2010. This has included further work on the Tulkubash zone, especially the T0700 project area. Historically this is the least explored of the three zones and currently contains 366,000oz of gold at 4.18g/t. The company has just announced that it has carried out geo-technical, pit design and optimisation plans and now believes that this is amenable to open pit mining at much lower cost than the underground mine which would focus on the Contact zone.

Furthermore, recent work at T0700 has demonstrated that a significant proportion of the mineralisation is not sulphide and that the gold can be extracted through direct cyanidation, simplifying processing and greatly reducing the processing plant capex requirements.

The grade is very high for an open pit and suggests that Chaarat could have a low cost open pit mine running either prior to or in parallel to the development of the underground operations, on the Contact and Main zone which contain sulphide ore and will require pressure oxidation to process.

Chaarat is now examining the economic merits of the different development options available and has said that these will depend on the fund raising options available and optimising the use of capital and equipment. One limitation is the relatively small resource size. However the Tulkubash zone is the least explored of the three zones, with only limited drilling having been done to date. Chaarat report that preliminary studies indicate that there is considerable potential for the resource to be increased and is recommencing drilling on the Tulkubash zone this week.

In March, Chaarat announced a 20% increase in the total resource at the project from 3.339Moz to 4.009Moz of gold. This includes an increase in the Indicated proportion of the resource from 49% to 55% of the total resource.

As the new drilling season starts, Chaarat is conscious of both increasing the total resource further and improving the quality of the current resources into the reserve category by the end of the PFS. As a decision is made on how to develop the open pit areas, we could see an increase in the total resource as the cut-off grade is lowered in these areas to reflect the improved economics.

## Pre-Feasibility Study on Track for Q3 2010

Chaarat is currently targeting 200,000 ounces of gold per year and the PFS, managed by SRK (Johannesburg) is on track to be completed in Q3 2010.

### Underground Mining Method Selected

SRK is also preparing the mine design and along with Chaarat has now selected a mining method for the underground operation targeting the Contact zone. The mine-scheduling plans are currently being designed to determine the mining rate. These studies will be combined with the pit design work carried out on both the Main and Tulkubash zones to optimise the capital investment and the utilisation of equipment and determine the development plan.

Once the mine design has been completed, the ventilation and other facilities will be designed and included in the operational and economic models.

### Revised processing Plan should reduce both Capex and operating costs

RDI, a leading Denver based metallurgical laboratory, has developed a revised processing plan. Rather than whole ore pressure oxidation as discussed in the scoping study, processing will involve flotation of the ore and pressure oxidation of the float concentrate. Once oxidised, the concentrate and the tailings from the flotation circuit will be processed through a CIL (carbon in leach) plant and the gold extracted. This should result in a significant reduction in both capital and operating costs than were suggested in the scoping study and result in a higher recovery and production of gold on site. Bench scale trials are in process in order to further optimise the gold recovery parameters, but Chaarat believes that gold recoveries of approximately 88% to 90% are achievable. Once complete, the process plant engineering and design work will be conducted by SNC Lavalin, a Canadian based engineering and construction group.

A local Kyrgyz company, Eco-Services, is designing the tailing dam and site plan to comply with both local and "western" standards and legal requirements.

### Infrastructure

Chaarat has also been investigating the local infrastructure, both in terms of the economics and the impact on the local community. The optimal way to site is a route of 190 km from the nearest rail head, the majority on public roads with the last 40km to site on a private road. However, another option under consideration is to take an 80km detour around a mountain pass used by the local community. This would alleviate congestion and minimise the impact on the local community.

## Valuation

Our current valuation for Chaarat is on a risked NPV10 of the previous scoping study assuming Chaarat receive 88% of the value of the gold in concentrate. This currently stands at US$229m with an IRR of 26%. However, as this is based on a scoping study, which is more a proof of concept with ±30% to the cost and capex estimates we only attribute 60% of this value. Adding cash and in the money options this equates to a risked target price of US$1.22 per share. The company is aiming to complete the pre-feasibility study by Q3 2010, which could see a reduction both in Capex and operating costs estimates.

The possibility that the Tulkubash zone could be mined as a standalone high grade, low cost open pit would add substantial value to the company. Once the company has completed its latest economic studies and decided on the best approach to use we will include it in our valuation.

## Political Situation in the Kyrgyz Republic

In April President Kurmanbek Bakiyev was ousted, 5 years after he himself came to power on the back of the so-called “tulip” revolution.

A leading member of the opposition and former ambassador to the UK, Roza Otunbayeva has been chosen as leader of an interim government. The new government which is composed largely of opposition figures, has said it will only stay in power for six months until new presidential elections will be held.

After gaining power in April Roza Otunbayeva said that the government would ensure foreign companies were able to continue working in the country, stating that "We will help make sure that all our large investors work without disruptions" and "We will make sure our tax services work for the business and not against the business."

Chaarat has been unaffected by the change in government as the project is in the far west of the country and we expect the company to be able to continue to act unhindered, especially with the support of its major shareholder.

## Share Price Suffered Despite Strengthening Gold and US$

Since April the Chaarat share price has suffered whilst the gold price has continued to rise and the US$ appreciated against the UK pound. Chaarat has fallen from a high of 60.5p on 19th March to 40p prior to the recent operations update, whilst most gold companies have risen sharply, albeit with much volatility. We believe that once the new government becomes established and as events to date have had no impact on the company or the project, the company will be re-rated.

### Comparison of Chaarat Gold Share Price vs. Gold Price and Gold Price to the US$/GB £ exchange rate


*Source: Fidessa.*

Having a UK listing should help Chaarat benefit both from the strengthening gold price and the strengthening US$. Since our last valuation the US$: GB£ exchange rate has fallen from 1.55:1 to 1.44:1.

## Recommendation

Although country risk has always been a concern in the Kyrgyz Republic, the new interim government has moved to comfort foreign companies and no projects have been impacted by the change in regime. Meanwhile, the company is making great strides in developing the Chaarat project, which is only one of three sets of targets within the Chaarat license area. We expect the resource to continue to grow, and the latest developments in the Tulkubash zone, which is not included in our current valuation, represents significant upside potential. We therefore maintain our BUY recommendation, and with the strengthening US$ our target price has increased from 76.5p to 82p per share.

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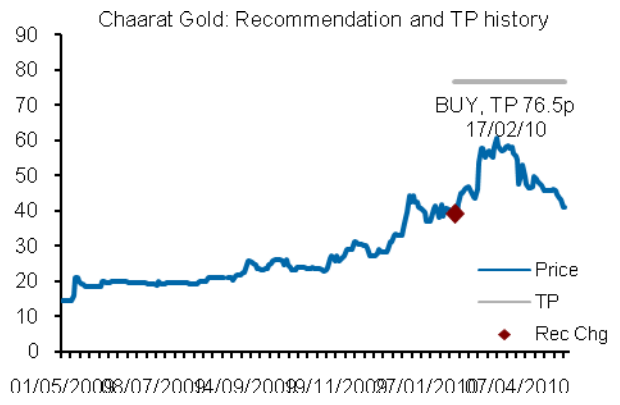


*Source: Fidessa, Westhouse Securities estimates.*

## Valuation basis

We have used an NPV calculation based on the results of the 2008 scoping study discounted at 10% with a 60% Risk Weighting, plus cash.

## Risks to our valuation

Chaarat operates in the Kyrgyz Republic where elections are expected within the next six months. Other risks are currency and gold price fluctuations.

This recommendation was first published on 18/05/2010.

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