

MINING RESEARCH

Chaarat Gold

39.5p

Initiation of Coverage

17 February 2010

Chaarat Gold Holdings (AIM: CGH) has a 3.34Moz JORC compliant gold resource at the Chaarat project in Western Kyrgyzstan. The company is due to release a resource upgrade followed by the results of a pre-feasibility study within the next few months. Chaarat is aiming to be in production by the end of 2012, initially producing circa 210,000oz of gold pa with associated by-product credits for a 13 year mine life. Significantly, as the current resource represents only 1.3km of the identified 10km strike of mineralisation, we expect the resource to increase substantially. We therefore initiate coverage of Chaarat Gold with a BUY recommendation and a target price of 76.5p per share.

Bull points

- JORC Resource of 3.34Moz of gold which is set to grow
- Only 1.3km of over 10km of mineralisation drilled, open along strike and down dip
- Fully funded to start of full feasibility study
- Resource update expected end Q1 2010
- Pre-feasibility expected Q3 2010
- Production of 210,000oz pa expected end of 2012
- Adit and cross-cuts already developed into Contact Zone
- Potential for lower cost oxide open pit in short term
- By-product credits reduce operating costs

Bear points

- Mineralisation largely refractory which may increase capex costs
- Mountainous terrain and weather will create logistical issues

BUY

ANALYST

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COMPANY DESCRIPTION

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

INVESTMENT DATA

Ticker	CGH
Listing	AIM
No. of shares	112.91m
Market cap	£44.6m

SHAREHOLDERS Holding (%)

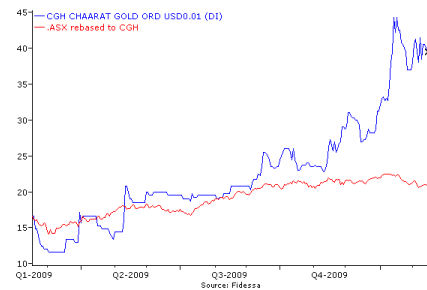
China Nonferrous Metals Int'l Mining Co. Ltd	19.9
Chase Nominees Limited	10.9
Mada Limited	10.2
Vetan Investments Limited	7.9
Christopher Palmer-Tomkinson & Family	5.9
Serra Choa Management	5.9
First State Investments	4.8

*As at 31 December 2009

SHARE PRICE PERFORMANCE

12m relative performance	+107.64%
3m relative performance	+53.84%
1m relative performance	-1.28%

12M SHARE PRICE PERFORMANCE



FTSE All Share rebased to CGH

Westhouse Securities acts as nominated adviser and joint broker to Chaarat Gold and is paid fees for these services.

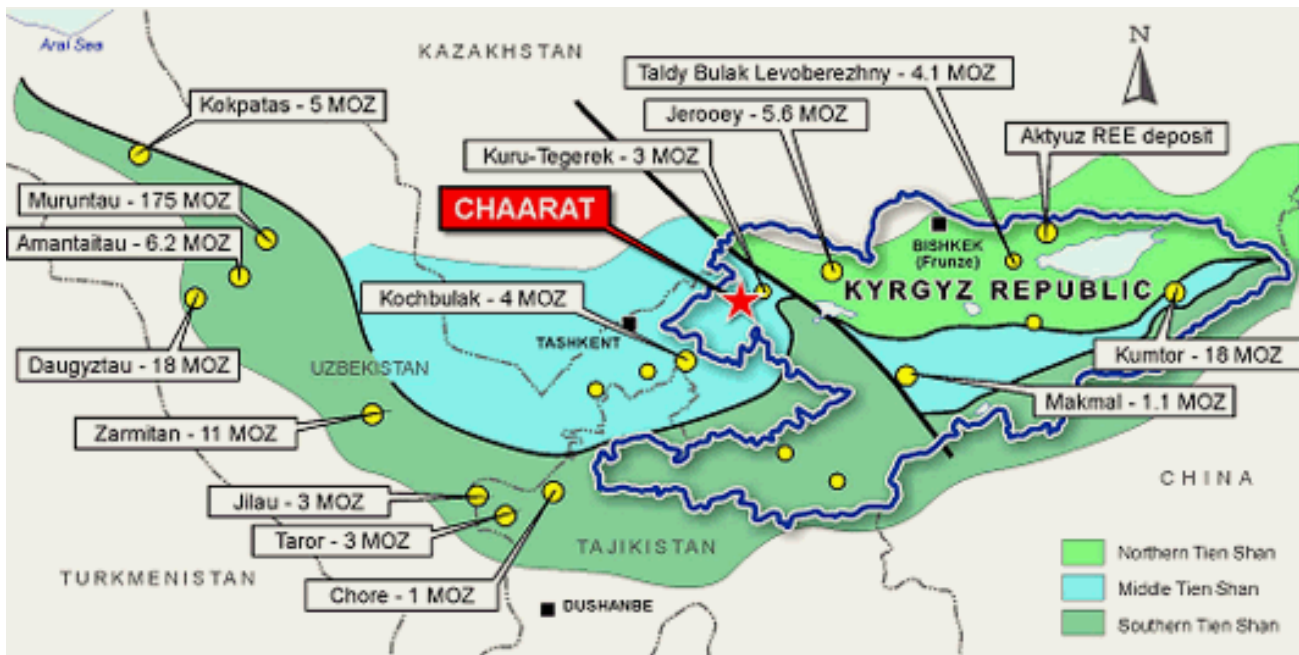
For important regulatory disclosures, please refer to the information on page 10 of this report.

Chaarat Gold – in the middle of a proven gold belt

The Chaarat gold project is located in the Sandalash Range of the Alatau Mountains in the Jalal-Abad province of western Kyrgyzstan, close to the border with Uzbekistan. It is approximately 300km southwest of the capital, Bishkek, and 140 to 180km by road from the nearest railway station at Maimak.

Geographically and geologically the Chaarat gold project lies in the middle of the Tien Shan gold belt, which extends across Central Asia from Uzbekistan in the west to China in the east. This is one of the most productive gold belts in the world, hosting truly world class gold deposits including Muruntau (175 million oz), Daugyztau (18 million oz) and Kumtor (18 million oz).

Chaarat – located in the heart of the prolific Tien Shan gold belt



Source: Company

In December 2002, Chaarat’s wholly owned Kyrgyzstan subsidiary Chaarat Zaav was issued a two year 439km² exploration licence by the State Agency of Geology and Mineral Resources. In March 2005, Chaarat Zaav extended the licence area to 604.6 km². Currently the licence is valid until the end of December 2010. Changes to the Kazakh mining law are due this year and under the new draft “Law on Subsoil” there will be three types of concessions; prospecting, exploration and exploitation. There appears to be little difference between these, other than the size of the concession payment, and we do not expect any difficulties for Chaarat transitioning to an exploration and mining concession as appropriate.

The current licence area includes three main targets along a 40km strike length. These are Kashkasu in the south, Chaarat in the middle and Minteke to the north, with all the work to date focusing in the central Chaarat target.

Geological setting

Kyrgyzstan covers a portion of the Tien Shan orogenic belt which stretches from northwest China, west through Kyrgyzstan, Uzbekistan and Kazakhstan. In Kyrgyzstan the belt forms three tectonic domains, the Northern, Middle and Southern Tien Shan with the Chaarat project lying in the middle Tien Shan.

The project occupies the north-eastern trending hinge zone of an anticline consisting of Upper Proterozoic or Cambro-Ordovician sedimentary rocks, which dip about 40° to the northwest. The lower sequence of meta-

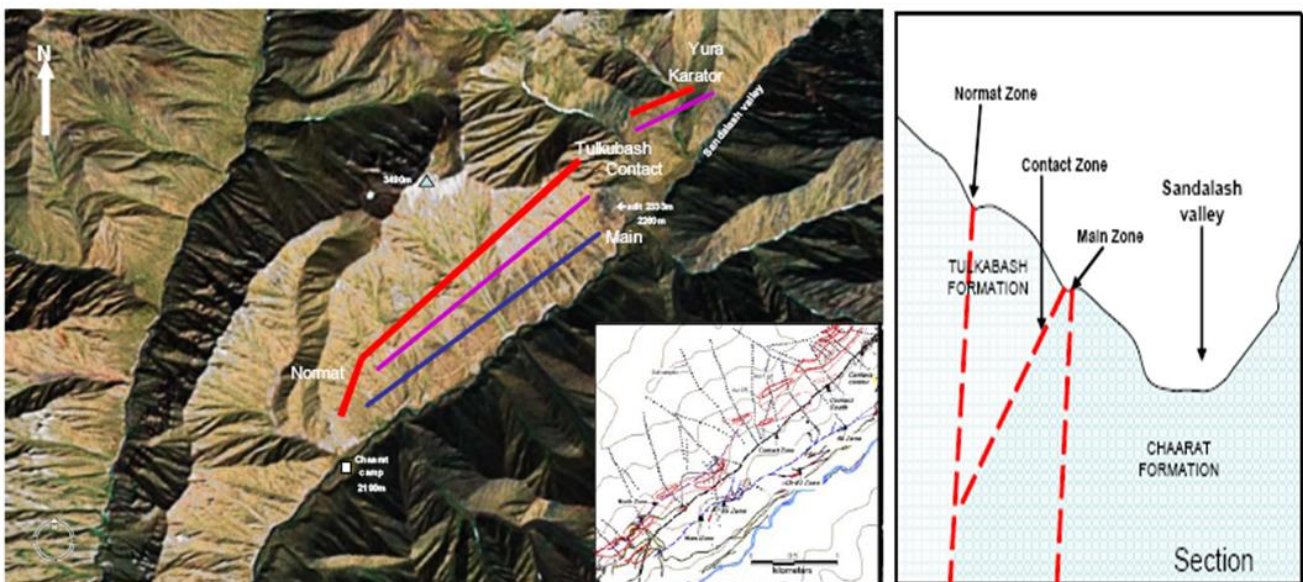
siltstone and sandstone is known as the Chaarat Formation whilst the upper sequence, predominantly comprising quartzites, as the Tulkubash Formation. Both have been faulted and igneous dykes intrude the faults in places.

The gold mineralisation is part of an extensive hydrothermal system which has exploited the faulting within both the Chaarat and the Tulkubash Formations and a major shear along the contact between the two formations. The shears have been traced intermittently at surface from the T07 Zone in the south to the Karator Area in the north, a distance of over 10km. The mineralised parts of the shear zones vary from 1m to over 20m thick and consist of gold-arsenopyrite-stibnite-tetrahedrite with minor quartz-vein stockworks and sericitic alteration. The gold is partially correlated with arsenic, predominantly as arsenopyrite, and occurs with associated silver and antimony.

Three potentially economic zones of mineralisation

Mineralisation at Chaarat occurs in three structurally controlled zones referred to as the Main, Contact and Tulkubash Zones. These structures have also divided the area along strike to the north and south, with Chaarat to the south and Karator to the north.

Plan and Schematic Cross section showing the Tulkubash (Normal), Contact and Main Zones at Chaarat



Source: Company

Main Zone

Main Zone open pit potential

The Main Zone area of mineralisation within the Chaarat Formation contains several discrete mineralised bodies 300 to 500m in length along a 4km strike. These are concentrated in seven sub-zones: M2400, M3000, M3400, M3900, M4400, M5000 and M6000. Drilling has demonstrated that these are not continuous, but form discrete zones of mineralisation between 300 and 500m in length. The zone remains open at depth and along strike, with significant potential remaining in additional lenses including M7000.

At least part of the Main Zone could be mined using open pit methods.

Main Zone resource estimate

Following the 2008 drill season SRK South Africa revised the resource estimate for the Main Zone, which now stands at 1.598 Moz of gold. As the Main Zone is likely to be a largely underground mining operation, this was calculated using a 2.0g/t cut-off.

Sub-Zone	Indicated Resources			Inferred Resources			Total Resources		
	Tonnes kt	Grade g/t Au	Contained Au oz Au	Tonnes kt	Grade g/t Au	Contained Au oz Au	Tonnes kt	Grade g/t Au	Contained Au oz Au
M2400	1,857	4.45	266,000	1,059	4.24	144,000	2,916	4.37	410,000
M3000	3,293	4.37	463,000	782	4.64	117,000	4,075	4.43	580,000
M3400				986	4.19	133,000	986	4.19	133,000
M3900	1,182	3.74	142,000	946	3.73	113,000	2,128	3.74	256,000
M4400				321	3.88	40,000	321	3.88	40,000
M5000	66	6.05	13,000	332	4.92	52,000	397	5.11	65,000
M6000	133	4.61	20,000	566	5.19	94,000	699	5.08	114,000
Total	6,531	4.3	904,000	4,992	4.33	693,000	11,522	4.31	1,598,000

Source: Company
NB 2.0g/t cut-off

Contact Zone

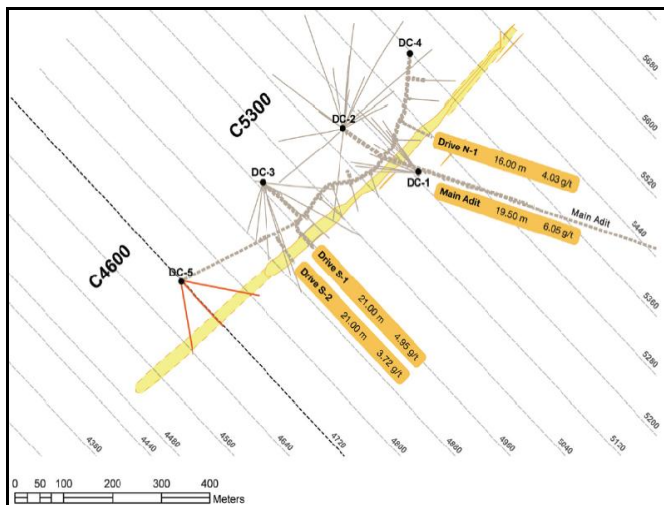
Continuous and remains open at depth and along strike

The Contact Zone, as the name suggests, lies along the contact between the Ordovician Chaarat Formation (siltstones and sandstones) and the overlying Devonian Tulkubash Formation (quartzites). The Contact Zone has been traced over 10km, of which only 1.34km has been drilled, and every hole drilled in the last two years has intersected mineralisation.

Within the Contact Zone are three sub-zones. Solid mineralisation occurs within both the C5300 and the C4600 sub-zones with the third sub-zone, C4000, demonstrating lower grade but still having resource potential. Mineralisation was intersected in the deepest drillhole (DDH 86) at a depth of 400m in C5300.

The mineralised envelope varies in width between 10 to 23m. Significantly, soil geochemistry has traced the Contact Zone for a further 5km to the northeast into the Karator area.

Contact Zone drill plan



Source: Company

Drilling in Drill Chamber DC-5



Source: Westhouse Securities

In 2007, Chaarat developed underground workings 275m below the surface outcrop of the Contact Zone, in order to access the mineralisation at depth, as well as complete bulk sampling and geotechnical work. After reaching the mineralised zone, a drift was developed parallel to the mineralisation which extended 485m to the south and 200m to the north of the adit. Two drilling chambers were built to allow drilling into the mineralisation.

Since then three cross-cuts have been developed through the mineralisation. The main adit intersected the Contact Zone mineralisation along Section 5160 over 22.4m (true width) at 5.78 g/t of Au. A further three underground drilling chambers were established from which a total of 6,819m of drilling were completed during 2008. Based on these drill results, SRK re-calculated the resource estimate for the Contact Zone. Using a 2.0 g/t cut-off the resource currently stands at 1.42 Moz of gold.

Resource estimate – Contact Zone

Sub-Zone	Indicated Resources			Inferred Resources			Total Resources		
	Tonnes kt	Grade g/t Au	Contained Au oz Au	Tonnes kt	Grade g/t Au	Contained Au oz Au	Tonnes kt	Grade g/t Au	Contained Au oz Au
C4000	122	3.6	14,000	538	3.61	62,000	660	3.61	77,000
C4600	480	3.91	60,000	2,002	4.28	275,000	2,482	4.21	336,000
C5300	3,071	4.24	419,000	4,291	4.29	591,000	7,362	4.27	1,010,000
Total	3,673	4.18	493,000	6,831	4.23	928,000	10,504	4.21	1,423,000

Source : Company (NB 2.0g/t cut-off)

During 2009 further drilling into the C5300 sub-zone was made from two drill chambers: DC1 (3 drill holes) to gain information regarding the mineralisation above the adit; and DC3 (9 drill holes) to get information on above and below the adit.

Also during 2009, the underground development continued along strike towards area C4600. The second southern drive (Drive S2) which is 240m south west of the main adit, intersected 24 metres of mineralisation with a true thickness of 21m at 3.72 g/t Au. The northern drive (Drive N-1) was developed to probe the north eastern continuity of the mineralisation intersected in the adit. This drive intersected 19m of mineralisation with a true thickness of 15.8m at 4.03 g/t Au.

The drilling results from the holes to the south of Drive S-2 effectively extend the strike length by a further 80 metres to 640 metres to the south, potentially adding significant additional resources. This further demonstrates the continuity of the mineralisation along strike between the C5300 and the C4600 sub-zones and suggests that they may converge to form a large continuous body. The mineralisation in C5300 remains open both along strike and down dip.

Tulkubash Zone

Early stage, but possible oxide open pit potential

The Tulkubash Zone is hosted in the Tulkubash quartzites and has not been as well explored as the Main and Contact Zones. However soil anomalies extend for 3km along strike, ranging in width between 100m to 300m which indicate the potential for oxide mineralisation that is amenable to open pit mining. As no drilling was carried out in the Tulkubash Zone during the 2008 drill season, the resource was not increased and currently stands at 319,000 oz of gold, calculated with a 2.0g/t cut-off to reflect the lower costs of open pit mining. However, as it has not been well explored to date there is potential for the current resource to increase significantly.

Resource estimate – Tulkubash Zone

Sub-Zone	Indicated Resources			Inferred Resources			Total Resources		
	Tonnes kt	Grade g/t Au	Contained Au oz Au	Tonnes kt	Grade g/t Au	Contained Au oz Au	Tonnes kt	Grade g/t Au	Contained Au oz Au
T0700	1,642	4.7	248,000	473	4.67	71,000	2,115	4.69	319,000

Source: Company (NB 2.0g/t cut-off)

Current total resource 3.338Moz and growing

After the 2008 drilling season the resource was recalculated for both the Main and the Contact zones, with the Tulkabash zone remaining unchanged. The current indicated and inferred resource stands at 3.338Moz of gold across the eleven zones at an average grade of 4.29 g/t.

Total current resource estimate (2008)

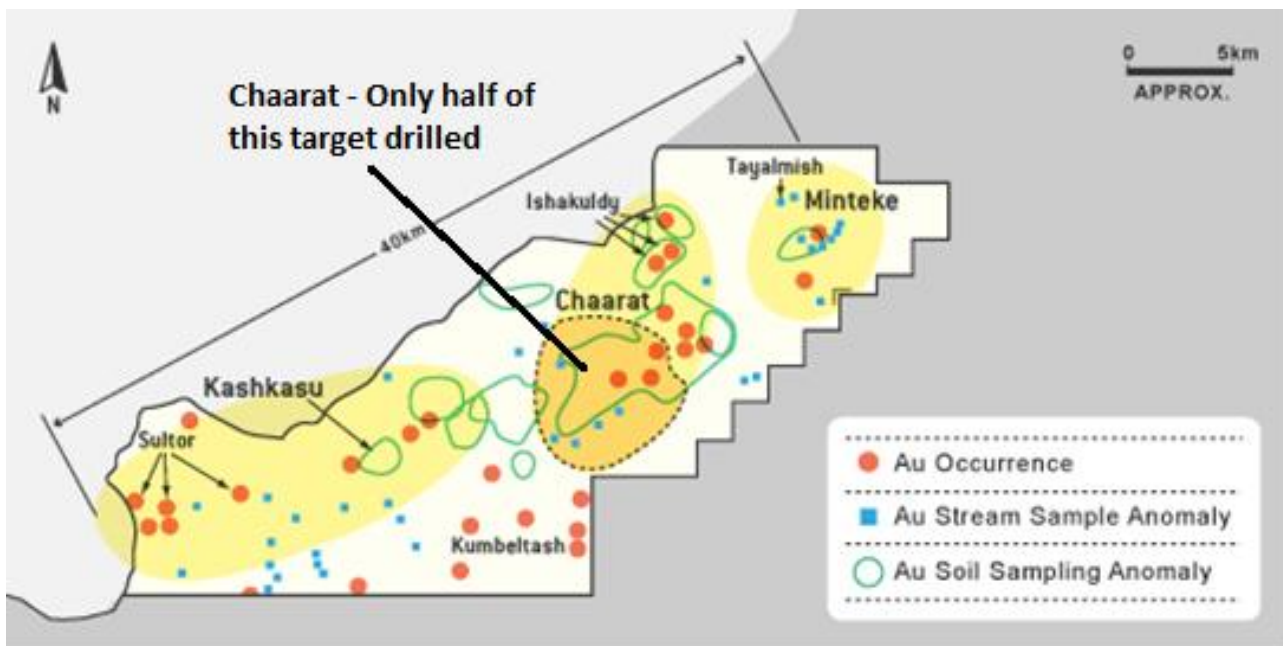
Sub-Zone	Indicated Resources			Inferred Resources			Total Resources		
	Tonnes kt	Grade g/t Au	Contained Au oz Au	Tonnes kt	Grade g/t Au	Contained Au oz Au	Tonnes kt	Grade g/t Au	Contained Au oz Au
Total	11,846	4.32	1,644,000	12,294	4.29	1,694,000	24,141	4.3	3,338,000

Source: Company

Since the 2008 resource update around 6,500 metres of drilling have been completed, with the latest results for the Contact Zone released on 10 February 2010 demonstrating good grades and intersections.

Chaarat aims to complete a resource update by the end of Q1 2010 and is targeting a resource of 5.0Moz by the end of 2010. Although this may appear ambitious, the work to date has only focused on the southern half of the Central Licence area and recent drilling continues to confirm geological continuity, particularly in the Contact Zone.

The Sandalash licence area – three targets, only one explored to date



Source: Company

Scoping study indicates technical and economic viability

The results of an initial scoping study by Behre Dolbear International were released on 19 June 2008 and after additional geological and metallurgical test work was undertaken, a revised scoping study was released on 15 December 2008.

In the initial scoping study, pressure oxidation was to be used as the mineralisation is associated with arsenopyrite with little if any free gold making conventional carbon in leach (CIL) or pulp (CIP) technologies inappropriate. However, in the revised scoping study this was replaced at least initially by a flotation circuit to produce a

concentrate. The key difference is the phased use of capex. Once the project is cash flow positive, leaching or pressure oxidation could be used to pour gold.

Summary of updated scoping study results

	Unit	Average years 1-5	Average life of mine
Tonnes mined per annum	T	1,814,396	1,794,203
Mill grade	g/t	4.67	4.41
Process Recovery to concentrate	%	85.00%	85%
Ounces mined annually	Oz	231,786	216,475
Ounces paid annually	Oz	203,971	190,498
Operating costs mining	\$/t	23.8	24.2
Operating costs processing	\$/t	6.7	6.7
Operating costs G&A	\$/t	2.8	2.8
Total operating costs	\$/t	33.3	33.8
Operating cash cost per ounce	\$/oz	296.1	317.9

Source: Company

There is a marked change in capex requirements between the initial and revised scoping studies from US\$320m to US\$229m for the phase one flotation circuit and a reduction in cash costs for gold production from US\$478 per ounce to US\$458 per ounce. Processing costs are lower due to the simpler processing route however shipping concentrate rather than refined gold increases shipping costs. Cash cost per ounce of gold production, including all revenue related taxes and by-product credits, were estimated at US\$373 per ounce over the first 5 years and US\$396 per ounce over the life of mine. This is an increase over the initial study of approximately US\$20 per ounce due to reduced value of the by-products.

The recovery rate of the flotation circuit remains at 85% although there would be a reduction in attributable gold and revenues due to smelter/offtake charges. The only other proposed change in the scoping study was to prioritise power independence. This would be achieved through a two stage process. Initially diesel generators would power the site, after which they would support the second stage implementation of a run-of-river hydroelectric power plant.

However, the exact processing route has not yet been decided, especially as sustained high gold prices make smelter charges unattractive and we expect further clarity from the company over the coming months as the results of metallurgical test work are released.

Regardless of the processing technology, the key production assumptions of the June 2008 study remain intact. Conventional log-hole open-stopping with backfilling and 4% dilution was assumed with a production rate of 5,000 tonnes per day.

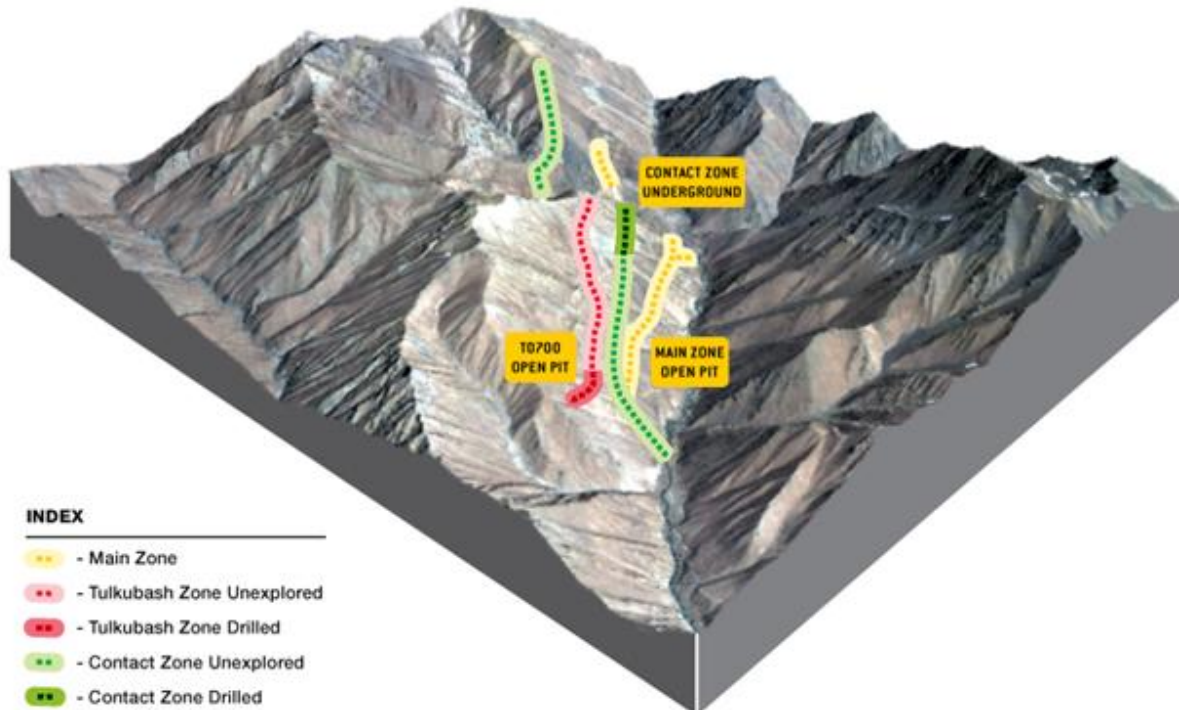
Based on the 2008 end of year resource of 3.34Moz gold, using a long-term gold price of US\$750 per ounce and a discount rate of 10% the revised scoping study estimated the Net Present Value (NPV) of the project to be US\$152 million. The Internal Rate of Return (IRR) is increased from 20.3% to 21.6%.

Since the December 2008 scoping study was completed the resource has increased and we expect it to increase again by the end of Q1 2010.

Chaarat has also been looking at developing an open pit for both the Main Zone and T0700 which would enable the company to quickly generate revenues, especially if there is a significant oxide or at least non-sulphide resource available.

Chaarat is now busy completing a pre-feasibility study which it expects complete in Q3 2010. If positive, it will be quickly followed up by a feasibility study with the aim of moving into production by Q4.

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



Source: Company

Potential attracts major Chinese investors

Given the huge potential of the project and the close proximity to China, it is not surprising that Chaarat has attracted interest from China. In July 2009 China Nonferrous Metals International Mining Company Ltd (CNMIM) agreed to subscribe for 22,469,289 shares in Chaarat at 25p per share for a consideration of £5.6 million. Regulatory approval was received from China in September and CNMIM now holds 19.9% of the issued share capital. In October CNMIM appointed Tao Luo and David Tang as non-executive directors. As part of the placing, Chaarat agreed not to exercise its right to require CNMIM to make a cash offer to shareholders under Chaarat’s articles of association, unless CNMIM reaches the 30% threshold.

Fully funded to full feasibility study

This was a good deal for Chaarat - it was at a significant premium to the then share price of 19p and it would have been difficult for the company to source the funds from the equity markets at that time. The funding received from CNMIM has allowed Chaarat to progress the pre-feasibility study which is now expected to be completed by Q3 2010, and be ready to start the full feasibility which is expected to be completed during 2011.

Valuation

In-situ resources

One method used to value pre-production gold companies is to use a multiple of the in-situ resources. Based on various near mine exploration gold projects globally, we are currently using a valuation metric of US\$80/ounce, US\$40/ounce and US\$20/ounce for measured, indicated and inferred ounces respectively. Based on Chaarat’s current resource, cash and in-the-money options, this values the company’s in-situ resources at US\$110m or £74.0m. However as we are expecting a resource upgrade imminently with the company targeting a 5.0Moz resource by the end of the year, we believe a 4.0 Moz resource split equally between indicated and inferred is

realistic within the next six months. This would give us a six month target of US\$130.5m or £83.5m, equivalent to 73.95p per fully diluted share.

DCF - scoping study

Using US\$ per ounce as a valuation metric can be unreliable as companies are at different stages of development and each project is unique. We have therefore re-visited the revised scoping study and used the assumptions made in it to evaluate the project using a DCF. We modelled the base case and calculated the NPV₁₀ as US\$150.55m with a 21% IRR which is very similar to the US\$152m calculated by the company. This is assuming a long term gold price of US\$750 and Chaarat receiving 88% of the value of gold in concentrate.

However, if we use our current gold price forecasts, this rises to US\$229m and the IRR increases to 26%. Based on the current 121.4m fully diluted shares and adding in current cash (US\$7.0m) plus the proceeds from options (US\$6.58m) this is equivalent to US\$2.00 per share.

As the forecasts are made on the results of the scoping study, which is more a proof of concept with $\pm 30\%$ to the cost and capex estimates, we normally apply a 0.6 multiple to the NPV. This gives a risked price of US\$1.21 per share. At the current exchange rate of US\$1.56 we estimate the value of Chaarat is 76.66p per share, which is close to our 'in-situ resource' valuation.

Project sensitivity to Gold price and discount rate

		Discount Rate				
		8%	10%	12%	14%	16%
Gold Price US\$/oz	750	197.5	150.6	111.7	79.3	52.1
	800	242.7	190.1	146.4	109.9	79.3
	900	333.1	268.9	215.7	171.1	133.7
	1000	423.4	347.8	285.0	232.3	188.1
	1100	513.8	426.7	354.3	293.6	242.4
	1200	604.1	505.6	423.5	354.8	296.8
	1300	694.5	584.5	492.8	416.0	351.2
	1500	875.2	742.3	631.4	538.4	460.0

Source: Company and Westhouse estimates

Recommendation

We believe that the outlook for Chaarat is excellent with a resource update due within the next couple of months, the results of the pre-feasibility study by Q3 2010 and the full feasibility study in 2011. We envisage that the main issue for the project is the logistics of operating in the Sandalash Valley, both in terms of the weather and the ruggedness of the terrain. However, visiting the site in January, in the middle of winter and observing the company's continuing operations, albeit underground, has allayed those fears. Although the gold mineralisation is associated with sulphides, the use of a flotation circuit to produce concentrate will reduce costs and speed up delivery. However, we await the results of further metallurgical test work which will give a clearer indication of which processing route would provide the best returns. In addition, the possibility of having a non-sulphide open pit operation in T07 and or in the Main Zone would allow the company to move quickly into cash generation.

Another feature of our visit was the observation of the scale of the project. The current 3.34Moz gold resource represents only 1.34km of the 10km strike length of the Contact Zone, as such we believe there is substantial upside to the current resource. With the company due to make rapid progress over the next few months we make a BUY recommendation for Chaarat Gold with a target price of 76.5p per share.

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