Classical Insights

Global Investment Analysis Based on the Classical Economic Model

Classical Insights Morning Bullet Points November 16, 2009

CRK CN -- $1.28

all figures in US dollars

Sales and earnings

	2010e	2011e	2012e	2013e
Sales ($ mln)	**107**	**198**	**270**	**296**
Sales growth		84%	37%	10%
EPS	**0.11**	**0.24**	**0.34**	**0.25**
Cash flow	0.13	0.28	0.40	0.31
FCF	(0.19)	0.04	0.28	0.21
Cons. EPS				

Target price & valuation data

Our 12-mo. target	$2.40	(9.5x 2011 EPS	
Upside to target	88%	+ $0.16/sh for YE '10 cash.)	
Mkt cap ($ mln)	$237	Enterprise value	$202
P/sales (2010e)	2.21	EV/sales (2010e)	1.88
P/E (2010e)	11.8	EV/EBITDA (2010e)	6.8
P/E (2011e)	5.4	EV/EBITDA (2011e)	3.1
P/E (2012e)	3.7	EV/EBITDA (2012e)	2.1

cash flow defined simply as EPS + depreciation. FCF defined as cash flow - capex.

Crocodile Gold began trading on the Toronto exchange two weeks ago. CRK owns a package of mines and mills in Australia's Northern Territory (near Darwin), that have the potential to produce 200,000+ gold ounces per year by 2011. The properties were bought out of receivership in April from GBS Gold, which went bankrupt during the depths of last winter's financial crisis. Crocodile's mines are not low cost, and most are on the smaller side. But CRK paid just $42 million for the mines, two mills and 3.8 million ounces of gold resources. Mining already has been re-started at two locations, and a third will be re-started in Q1 2010. The first gold pour is expected next month.

Points:

1) Here are my forecasts for gold production. They are essentially a more conservative version of management's forecasts:

Crocodile Gold: Production forecasts by mine (in ounces)

Mine	Full potential	Status	2010 * (ozs)	2011 * (ozs)	2012 (ozs)	2013 (ozs)
Chinese pits (milled)	55,000	started	41,000	44,000	50,000	50,000
Chinese (heap leach)	50,000	Q4 2010	0	35,000	42,000	47,000
Brocks Creek	30,000	started	22,000	27,000	29,000	30,000
Tom's Gully	55,000	Q1 2010	32,000	42,000	48,000	50,000
Cosmo	95,000	mid 2011	0	27,000	70,000	85,000
Maud Creek	0	maybe 2013	0	0	0	???
Total	285,000		95,000	175,000	239,000	262,000

Sources: Churchill Research estimates, CRK CN

** Management is forecasting 100,000+ in 2010 and 200,000+ in 2011.*

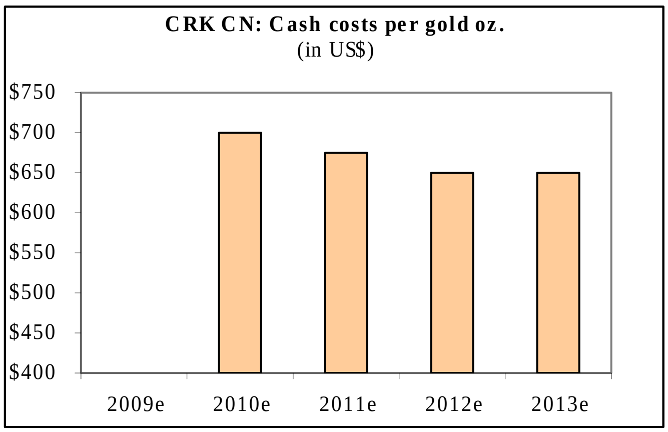
2) Now-defunct GBS Gold had been targeting 300,000 ounces/year of production from these assets back in mid-2008. Production was 102,000 ounces in 2007, followed by 91,000 ounces for the first nine months of 2008 (or about 121,000 ounces annualized). GBS had been pouring capital into the mines in 2008 -- but ran into a string of problems, according to Crocodile's 43-101 report issued in July, 2009:

- Stope collapse at Brocks Creek;

- Dilution of ore grades due to inappropriately-sized equipment;
- Delays in development at Tom's Gully;
- The need to remove large quantities of waste from the Chinese open pit, which increased cash costs;
- High haulage charges due to high fuel costs;
- Inability to raise money due to tight capital markets.

GBS Gold's cash costs had been in the mid-$600s/oz. in 2007. They rose to the mid-$700s in H1 2008 and then shot up to $974/oz. in Q3 2008 due to the factors mentioned above.

3) CRK management believes it can do a better job with the former GBS mines, and it seems plausible to me that they can, given what appear to have been sub-optimal mining practices by GBS. Importantly, the overall cash cost of the mines should move downward in late 2011 with the ramp-up of the 95,000-ounce-per-year Cosmo mine. That mine is expected to have cash costs below $450/oz., according to management (though I assume a higher figure). Here are my cash cost forecasts for the company as a whole:



My forecasts are above management's. (CRK management is expecting cash costs in the low-mid $600s/oz. for 2010.) One helpful point here is that the two mills were kept in good shape while the mines were inactive. The motors were re-started weekly, for instance.

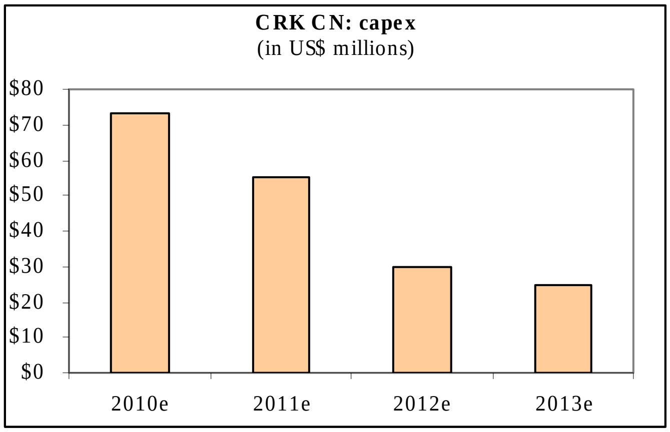
4) CRK's gold deposits amount to 4.8m ounces, in four main locations on the firm's 3500-square-kilometer land package. The average grade is 2.25 g/tonne.

Crocodile Gold: gold resource

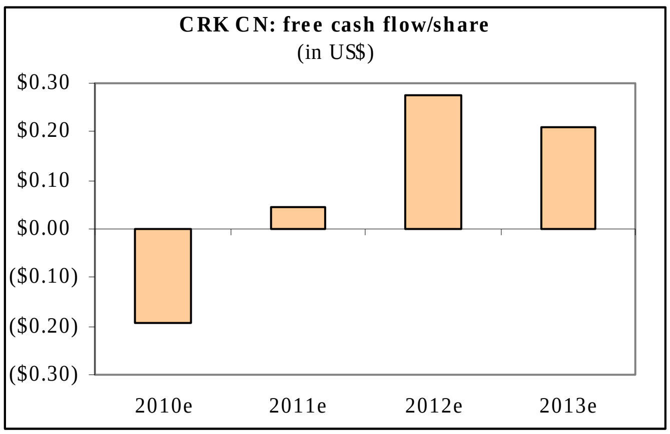
	Gold reserves (tonnes)	Gold grade (g/tonne)	contained gold * (mln. ozs)	assuming 75% recovery rate
Crocodile Gold: gold resource	**66,800,000**	**2.25**	**4.84**	**3.6**
Measured & Indicated	40,900,000	2.25	2.96	2.2
Inferred	25,900,000	2.26	1.88	1.4
Years of life @ 2012 rate (239,000 ozs./year):			**15.2**	

Sources: Acme, Churchill Research estimates

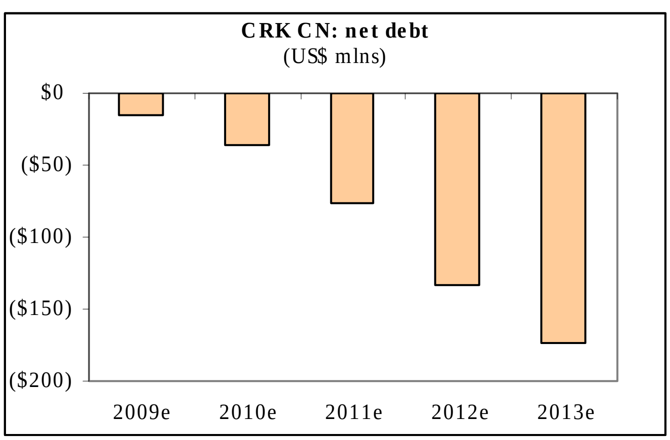
5) Crocodile has cash of $35 million and access to a $25 million credit line. The firm expects capex of about $32 million in 2009, rising to $62 million in 2010 and then falling to $38 million in 2011 and $14 million in 2012. I'm using somewhat higher figures ($73 million in 2010, followed by $55 million in 2011, $30 million in 2012 and $25 million in 2013).



6) I expect CRK to end 2009 with $15 million in cash. If we assume a gold price of $1,129/oz. *ad infinitum*, CRK should be slightly free-cash-flow positive in 2011. I am modeling for -$0.19/share in free cash flow for 2010, rising to +$0.04/share in 2011 and $0.28/share in 2012. (Free cash flow falls in 2013 because in that year the firm should start paying taxes.)



7) In my model, CRK's balance sheet is always cash positive. The firm has no debt at present, though it does have a $25m credit line. CRK should get cash from three sources: gold sales, warrant issue and new-share issuance. CRK has 48 million warrants and options outstanding. If we assume those get converted for about $1/share (spread across 2010 and 2011) that would be $48 million in new cash. In addition, I assume CRK places another 40 million shares in 2010, plus a further 10 million each in 2011, 2012 and 2013. So, between these various sources, CRK should have a steadily-rising cash balance:



8) Valuation: I am valuing CRK at 9.5x expected 2011 earnings of US$0.24/share plus $0.16/share in cash as of the end of 2010. My forward P/E is below average, reflecting the above-average risk level with this firm. Plenty of things can go wrong here. Top areas for potential disappointment would be higher-than-expected cash costs and capital costs, combined with lower-than-expected production. The model assumes a $1,129/oz. gold price through YE 2013.

Crocodile: Income statement items (in US$)

	2010e	2011e	2012e	2013e
Sales (US$ mln.)	107	198	270	296
Cash costs	67	118	155	170
Depreciation	5	10	13	15
SG&A	11	14	17	20
Op income	24	56	84	91
Interest costs	0	0	0	0
Income tax	0	0	0	27
Net income	24	56	84	63
Shares (dil.)	225	235	245	255
EPS	0.11	0.24	0.34	0.25
Capex	(73)	(55)	(30)	(25)
FCF/share	(0.19)	0.04	0.28	0.21

Source: Churchill Research estimates

I will be adding CRK CN to the Classical Insights portfolio.

Mike Churchill

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