Caledonia Mining Corp

13 November 2014

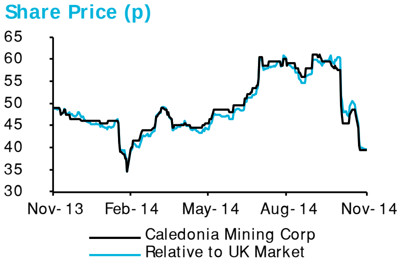
Quarterly Results

BUY

Current Share Price	40p
Target Price	75p
Market Capitalisation	£21m
Shares In Issue	52m
RIC/BLBG	CALq.L/CMCL LN
Avg. Daily Volume (3M)	32,151
Broker	Yes

Current share price(s) timed at 4:30PM on 12/11/14

Share Price (p)



Performance (%)	1M	3M	12M
Absolute	-31	-32	-18
Relative	-34	-32	-17

Source: Datastream (relative to UK-DS Market index)

Building a Golden Future

Q3 results are in line with an adjusted EPS of 1.0c, down y-o-y due to lower production, gold price and tax changes. Production was 9.9koz at an AISC $1,021/oz, bang in line, looking to be heading for a small beat on guidance. Positive cash generation through the quarter increased the cash pot to C$27m, keeping the divi policy intact through next year. We incorporate the new production plan into our model and reinstate our BUY recommendation at a slightly lower TP of 75p, from 80p, with a higher NAV offsetting lower CF in our valuation blend. Caledonia remains one of our favoured gold juniors, being a cash generative business with strong growth and one of the highest yields in the sector. Stock trades at a cheap 0.4x P/NAV, 3.7x P/CF and 1x EV/EBITDA, and is oversold with an RSI of 14.

- **Q3 in line**. Adjusted EPS came in at 1.0c, in line with Num 1.1c, down y-o-y due to lower production, gold price and tax changes. NPAT was C$1.1m, 4% lower than Num C$1.15m. Production reported previously at 9.9koz. Cash costs came in $698/oz and AISC $1,021/oz, bang in line, up y-o-y and q-o-q due to lower ounces. YTD production is 31.5koz at $656/oz; AISC $938/oz. Looks to be heading for a small beat on downgraded 40koz guidance (Num 41koz). YTD adjusted EPS of 8.8c, is tracking in line with our forecast 10c for the year. Op cashflow of C$3.6m. Cash was up q-o-q at C$26.9m, also in line, showing continued positive FCF generation. The divi policy reamins intact for 2015. Exploration of satellite properties is ongoing with encouraging results - we could see some ore put through the plant next year, which is not factored into our numbers (potential 10-15kozpa).

- **Revised production plan**. Following a strategic review, CMCL decided its cash is better spent expanding Blanket rather than M&A. The new revised plan is to increase production to 75-80kozpa by 2021 based on sinking a new central shaft and developing a tramming loop. Capex will be $70m over 5 years, funded by internal cashflow and CMCL's $26m cash pile. The strategy seems sensible given the current investment climate, in our view, and will make the operation more robust and bring down cash costs. It will improve underground infrastructure and logistics and allow a more efficient and sustainable production build-up. The new plan has slightly higher production levels than the original plan, but slower ramp-up and higher capex. Our NAV/sh increases by 16% to 95p, from 82p. Our 2015 & 16 EPS is reduced by 55% and 45% to 9c and 17c.

- **Investment thesis affirmed**. We affirm our view that Caledonia is one of the best gold juniors out there. Looking past Zimbabwe political risk, it hosts a fully indiginised, profitable operation with bottom quartile costs (AISC $900/oz) and low capital intensity growth. It is doubling production to 80kozpa and reducing costs by 25%. It generates cash, pays a 7% yield, has plenty of upside potential (Upside TP 105p) and trades at distressed multiples of 0.4x P/NAV and 1x EV/EBITDA. It is one of the most oversold stocks in the sector with an RSI of 14.

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Valuation: Growth and Upside

Our target price for Caledonia is 75p/sh, based on a blend of 1x P/NAV and 5x 1 year forward P/CF, in line with historic trading ranges. We value gold producers at 1-2x P/NAV and 5-15x 1 year forward P/CF. We believe that Caledonia deserves to trade at the bottom of this range as a profitable junior producer with a solid, low-cost production base and healthy growth profile, offset by high political risk in Zimbabwe.

We value Caledonia at $107m or 95p/sh, using an NAV based on DCF models at a discount rate of 14%, in line with our normal valuation methodology (12% discount rate for high risk plus 2% project risk). We have generally been more conservative in our model than management estimates. Caledonia currently has $25m in cash and no debt.

Our forward-looking valuation shows a healthy 20% increase over the next two years, excluding any upside from exploration, acquisition or higher metal prices. In reality we would expect this to be higher as Caledonia extends mine life at Blanket and develops the satellite properties.

Table 1: Forward-looking Valuation Estimates

Net Asset Value	Disc Rate (%)	NAV (%)	Current	FY14	FY15	FY16
Blanket (49%)	14	107	100	110	123	130
Exploration Properties		0	0	0	0	0
Sub-total			**100**	**110**	**123**	**130**
Cash & Equivalents		27	25	27	16	8
Debt		(1)	(1)	0	0	0
Corporate G&A		(33)	(31)	(32)	(30)	(28)
Total NAV ($m)			**93**	**105**	**109**	**110**
Shares O/S (m)			55	55	55	55
NAV ($/sh)			1.70	1.91	1.98	2.00
NAV (£/sh)			**0.95**	**1.07**	**1.11**	**1.12**
CFPS (£, 1 year forward)			0.11	0.09	0.15	0.15
NAV valuation	Target Multiple	1x	0.95	1.07	1.11	1.12
Cash Flow valuation		5x	0.54	0.47	0.75	0.75
VALUATION (£)			**0.75**	**0.77**	**0.93**	**0.94**
% Change				*3*	*20*	*20*

Source: Company & Numis Securities Research

Upside: Risks Skewed to the Upside

1. **Organic growth:** Caledonia expects to increase production to 75-80kozpa, from 40kozpa, by 2021. In a difficult gold price environment, we believe organic growth is the best way to counteract any potential price volatility and reduce costs.
2. **Satellite properties:** Caledonia has upside to increase production further from its satellite properties GG & Mascot. These have potential to produce an additional 10-15kozpa ramping up from 2015/16, by our estimates. This has potential to add $10m (10p/sh) to our NAV.
3. **Grade improvement:** With further work, Caledonia may be able to improve the grade beyond the current reserve grade of 3.8g/t, from which our model is factored on. We estimate a modest increase to 4g/t could add around $10m (10p/sh) to our NAV.
4. **M&A:** In the future, we believe Caledonia may be in a position to pick up other properties in Zimbabwe. Given current market conditions and the distressed state of a number of cash-strapped junior companies, we believe Caledonia will be able inundated with approaches. For a company with strong FCF generation potential and hungry plant, we believe this puts the company in an excellent negotiating position to pick up some real bargains when the time is appropriate.

Best Case Outweighs Worst Case

Our best case valuation estimate outweighs our worst case. Our best case target price is 105p, assuming five more years mine life at Blanket, a 0.2g/t improvement in grade to 4g/t, 10kozpa more production from the satellite properties and a 10% decrease opex. Our worst case target price is 60p, assuming a 10% opex/capex increase, 1 year delay to the production plan and a 0.3g/t drop in grade to 3.5g/t.

Table 2: Best and Worst Case Valuation Estimates

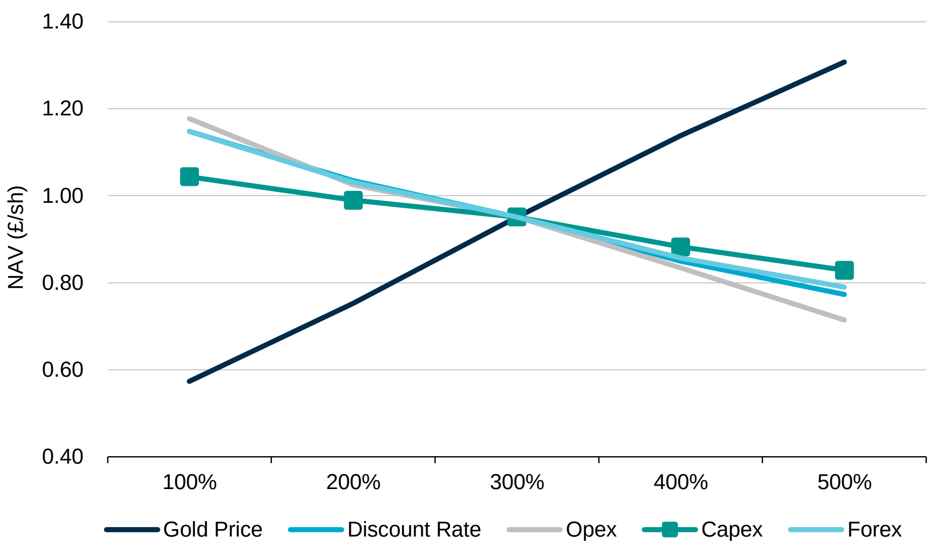
Net Asset Value	Worst	Base	Best
Blanket (49%)	70	100	160
Exploration Properties	0	0	0
Sub-total	**70**	**100**	**160**
Cash & Equivalents	25	25	25
Debt	(1)	(1)	(1)
Corporate G&A	(31)	(31)	(31)
Total NAV ($m)	**63**	**93**	**153**
Shares O/S (m)	55	55	55
NAV ($/sh)	1.15	1.70	2.79
NAV (£/sh)	**0.65**	**0.95**	**1.57**
CFPS (£, 1 year forward)	0.11	0.11	0.11
NAV valuation	0.65	0.95	1.57
Cash Flow valuation	0.54	0.54	0.54
VALUATION (£)	**0.59**	**0.75**	**1.05**
% Change	*(26)*		*29*

Source: Company & Numis Securities Research

Decent Gold Leverage

Caledonia has decent gold leverage with reasonable sensitivity to our price forecasts due to its low opex and capex base. Our NAV estimate increases 21% for a 10% increase in the gold price, within the industry norm of around 20-25%. The NAV also shows limited sensitivity to operating costs - decreasing by 11% for a 10% increase. Our NAV shows some sensitivity to forex, capex and discount rate.

Figure 1: Sensitivity Analysis (% change)



Source: Numis Securities Research

Table 3: NAV Sensitivity (£/sh)

Gold Price ($/oz)	10%	12%	14%	16%
1,000	0.98	0.82	0.69	0.58
1,100	1.15	0.98	0.84	0.73
1,200	1.39	1.20	1.04	0.91
1,300	1.60	1.38	1.21	1.06
1,400	1.78	1.54	1.35	1.18
1,500	2.06	1.79	1.57	1.39

Source: Numis Securities Research

Peer Group: Zimbabwe Risk Discount

Caledonia is currently trading at the lower end of the peer group at around 0.4x P/NAV, versus the average at 1.1x P/NAV. It is also trading at around 4.2x 2015 P/CF and 1x EV/EBITDA, versus the average at 6.0x and 4.3x, making it a cheap looking stock, mainly as a function of the Zimbabwe risk. In our view, we would expect the stock to receive a re-rating once a track record is built up, growth plans are put into effect and political risk is mitigated.

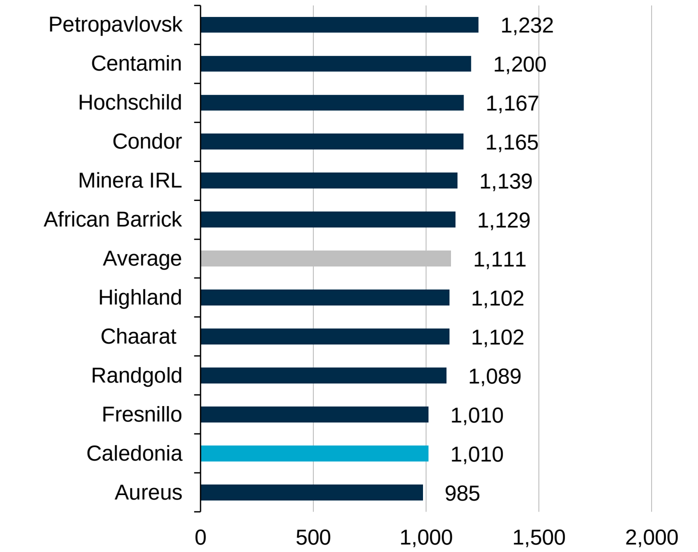
Caledonia is trading at around an EV/reserve of $30/oz and an EV/production of $591/oz, which is well below its peers at $213/oz and $2,619/oz. Caledonia trades at an implied gold price of $1,010/oz, below the peer group average of $1,111/oz. Another attraction of Caledonia is its yield, which is one of the highest of the miners on the LSE. It has an RSI of 14, the most oversold stock in our peer group.

Table 4: Peer group analysis

Company	Ticker LN	Rec.	Share Price (£)	Target Price (£)	Implied Return (%)	Market Cap (£m)	EV (£m)	Net Cash (£m)	RSI	P/NAV (x)	P/E 2015F (x)	P/CFPS 2015F (x)	EV/EBITDA 2015F (x)	EV$/oz Rec	EV$/oz Resv	EV$/oz Prod
Fresnillo	FRES	BUY	7.27	11.00	51	5,357	5,612	255	45	1.2	39.5	11.6	12.1	210	685	5,845
Randgold Resources	RRS	BUY	41.42	49.00	18	3,838	3,798	(40)	53	1.7	31.5	12.7	12.5	276	405	5,593
African Barrick Gold	ABG	BUY	2.14	2.80	31	879	790	(90)	57	1.5	13.9	5.2	4.7	47	93	1,628
Centamin Egypt	CEY	HOLD	0.52	0.60	17	593	507	(87)	41	0.9	7.5	4.3	3.6	55	105	1,584
Hochschild	HOC	HOLD	0.95	1.40	47	349	464	115	29	1.4	52.1	3.0	3.8	50	291	1,777
Highland Gold*	HGM	BUY	0.32	0.90	183	103	251	148	33	0.5	3.9	1.7	3.2	35	156	1,272
Petropavlovsk	POG	REDUCE	0.22	0.20	(9)	43	600	557	46	(3.0)	n.a.	2.5	5.5	65	104	1,599
Aureus Mining*	AUE	BUY	0.18	0.40	122	56	70	14	42	0.5	n.a.	6.2	6.1	111	137	1,797
Condor Gold*	CNR	BUY	0.82	1.00	22	38	32	(5)	43	0.6	n.a.	n.a.	n.a.	22	n.a.	n.a.
Chaarat Gold*	CGH	BUY	0.12	0.25	108	30	26	(4)	35	0.4	n.a.	n.a.	n.a.	8	16	n.a.
Caledonia Mining*	**CMCL**	**BUY**	**0.40**	**0.75**	**90**	**21**	**7**	**(14)**	**14**	**0.4**	**8.0**	**4.2**	**1.0**	**224**	**30**	**591**
Minera IRL	MIRL	BUY	0.05	0.15	226	11	22	11	28	0.3	n.a.	n.a.	nm	19	31	1,776
Polyus Gold	PGIL	N/C	1.88	-	-	5,700	6,093	393	53	-	21.2	14.3	11.6	93	119	5,641
Polymetal	POLY	N/C	5.29	-	-	2,226	2,833	607	61	-	16.2	7.1	7.9	129	289	3,531
Pan African	PAF	N/C	0.12	-	-	224	223	(1)	45	-	8.6	6.2	4.4	16	39	1,723
Kirkland Lake	KGI	N/C	2.05	-	-	148	197	49	31	-	13.3	4.1	5.1	171	220	1,937
Shanta Gold	SHG	N/C	0.10	-	-	45	69	24	37	-	2.5	3.2	2.7	51	234	1,333
Amara Mining	AMA	N/C	0.15	-	-	48	55	7	28	-	n.a.	n.a.	n.a.	25	71	1,500
Avocet Mining	AVM	N/C	0.05	-	-	10	49	39	43	-	n.a.	1.0	2.5	17	60	719
Average (Producers)						**1,502**	**1,650**	**148**	**42**	**1.1**	**18.2**	**6.2**	**6.0**	**109**	**213**	**2,619**
Average (Non-Producers)						**32**	**42**	**10**	**37**	**0.5**	**n.a.**	**3.6**	**4.3**	**34**	**63**	**1,448**

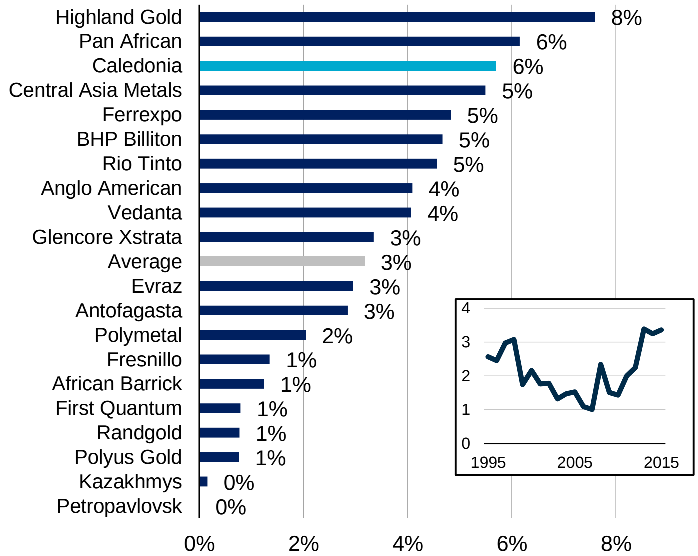
*Priced as of 4.30pm 12 November 2014 *Corporate broking client of Numis Securities*
Source: Company data, Numis Securities Research, Bloomberg

Figure 2: Implied Prices



Source: Company data & Numis Securities Research

Figure 3: Dividend Yield (2014F & Historic)

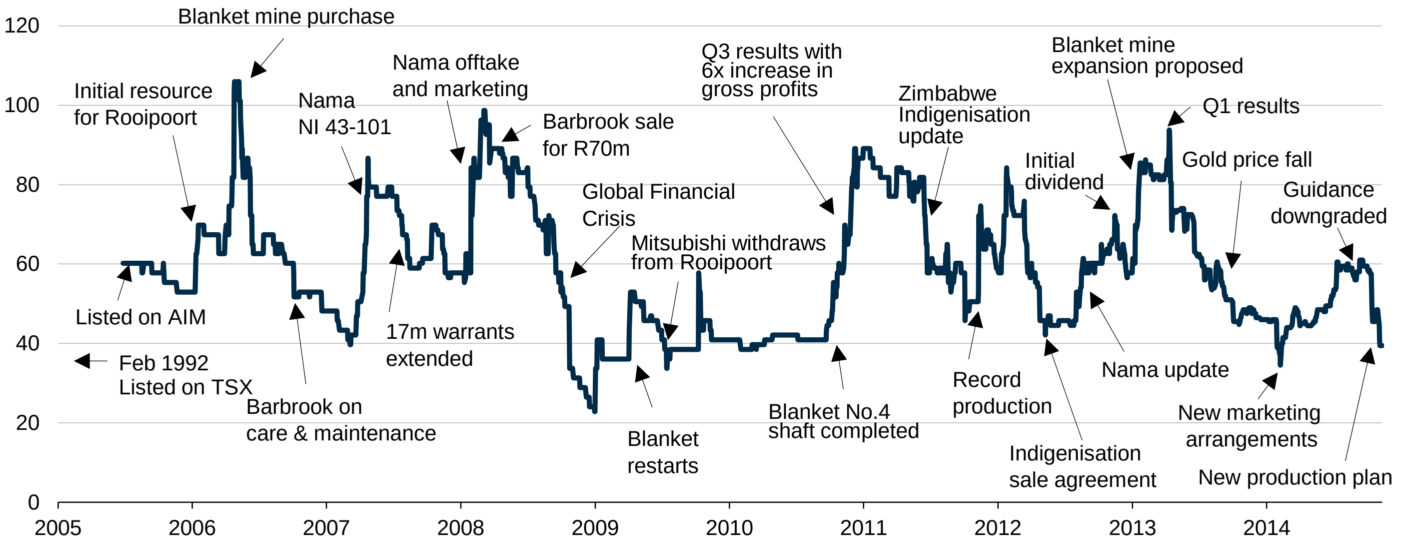


Source: Company data & Numis Securities Research

Caledonia: Sustaining the Golden Yield

Caledonia Mining Corporation is an AIM and TSX-listed junior gold producer focused in Zimbabwe. Its flagship asset is the low cost, cash-generative Blanket mine in Zimbabwe, which is fully indigenised and being expanded to 75-80kozpa by 2021, from the current 40kozpa. The company's corporate strategy is to be a sustainable, high yield gold business with growth.

Figure 4: Company Timeline and Share Price Graph



Source: Caledonia Mining Corporation, Bloomberg

Caledonia was listed on the TSX in February 1992 and on AIM in June 2005. The company originally had a wide range of assets, which were later divested. In 2006, Caledonia purchased the Blanket mine from Kinross for $4m and re-started production April 2009, having been temporarily shut down in the Zimbabwe turmoil. As the government loosened controls on gold sales and flow of funds, management expanded the mine to 40kozpa in late 2010 through management improvements, and began to make profits. In 2012 the mine was fully indigenised, with 51% interest sold for $30m to a variety of partners. In 2013, Caledonia announced its plans for expanding Blanket and reported its first annual dividend.

Table 5: Board & Management

Leigh Wilson	Chairman	Director of Victory Fund and CEO of New Century Home Health. Former CEO of Paribas North America.
Stefan Hayden	CEO	Wide range of managerial, electrical and mechanical experience. Founder of a mining machinery company and South African heavy electronics arm of Toshiba. Former manager at Massey Ferguson and CEO of Eersteling & Barbrook mines. Joined Caledonia in 1999.
Steve Curtis	CFO	Chartered accountant with 24 years' experience. Former FD of Avery Dennison SA and Jackstadt SA.
James Johnstone	Director	Mining engineer with 40 years' experience, Including 20 years in GM or COO positions.
Robert Babensee	Non-Exec Director	Chartered accountant and former partner of BDO Dunwoody. NED of Apollo Gold and former CFO of Golden China Resources.
Richard Patricio	Director	VP Legal & Corp Affairs at Pinetree Capital (10% shareholder). VP at Mega Uranium, & Brownstone
Leigh Wilson	Director	Director of Victory Fund and CEO of New Century Home Health. Former CEO of Paribas North America
Johan Holtzhausen	Director	Former Partner of KPMG South Africa. Chairman of Finance, Audit & Risk Committees of Tourism
Dr. Trevor Pearton	VP Exploration	Former rated SA gold analyst and mining consultant. Joined Caledonia in 2001.
Dana Roets	COO	Mining engineer with 24 years' experience, including Gold Fields and Great Basin Gold.
Mark Learmouth	VP Corporate Development	Chartered accountant with 17 years' experience in banking, formerly with Macquarie First South.
Caxton Mangezi	GM	Mine manager who has worked on Blanket in a number of roles since 1969. GM since 1993.

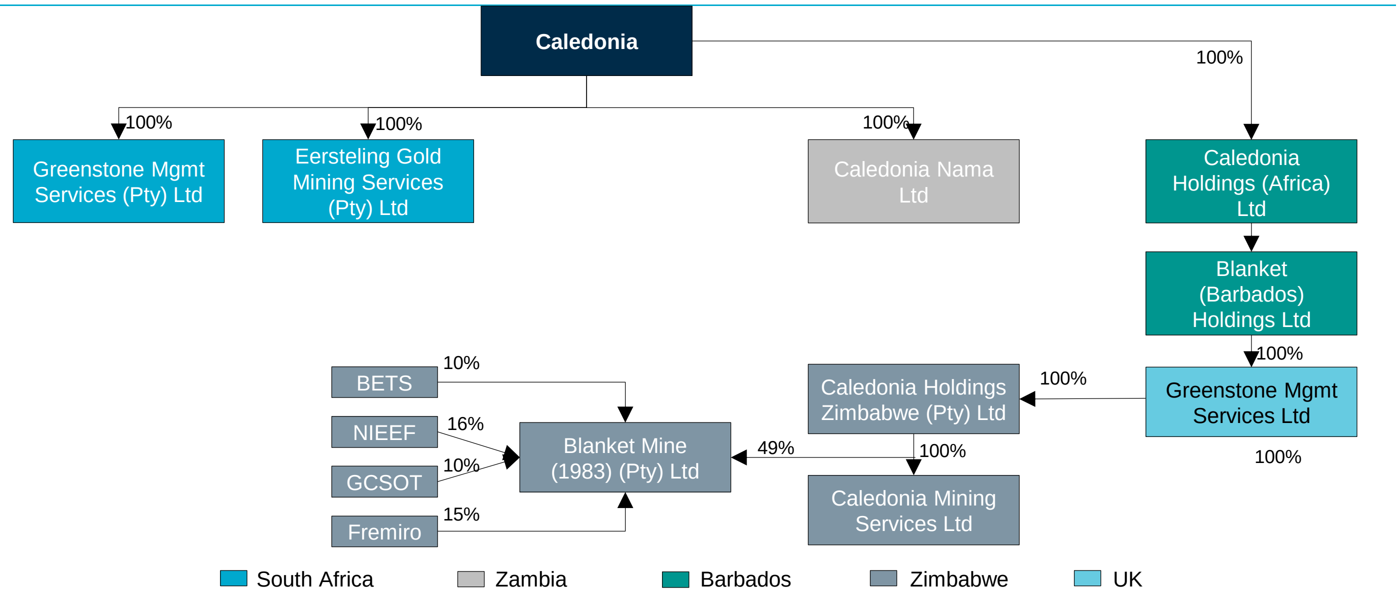
Source: Caledonia Mining Corporation

Corporate structure: Fully Indigenised

Caledonia's Blanket mine in Zimbabwe is fully indigenised at 49% ownership, following the 2007 Empowerment Act. Caledonia has pioneered the corporate ownership structure in the country and was the first mining company to meet the requirements. Caledonia sold the 51% interest for $30m in 2012 to a group of indigenous shareholders, comprising:

- National Indigenisation and Economic Empowerment Fund (NIEEF) – 16%
- Fremiro, owned by Indigenous Zimbabweans - 15%
- Blanket Employee Trust Services (BETS) – 10%. For the benefit of present and future managers and employees of Blanket, with participation units held in a trust.
- Gwanda Community Share Ownership Trust (GCSOT) - 10%. Interest donated by Caledonia.
- Caledonia's empowerment accounting is cleverly structured, in our view. The $30m sale transaction was vendor-financed by Blanket. Purchasers (the indigenous partners) repay their loans from 80% of their attributable Blanket dividends (49%). The outstanding facilitation loans attract a decent interest rate of LIBOR plus 10% and Caledonia also charges a c.$4m pa management fee to Blanket's indigenisation vehicle. The net result means that cashflows to Caledonia is significantly higher than the 49% interest. Dividends paid out by Blanket are obviously post-tax and post-capex, so any additional investment in the business would defer the 49% payout further.

Figure 5: Corporate Structure

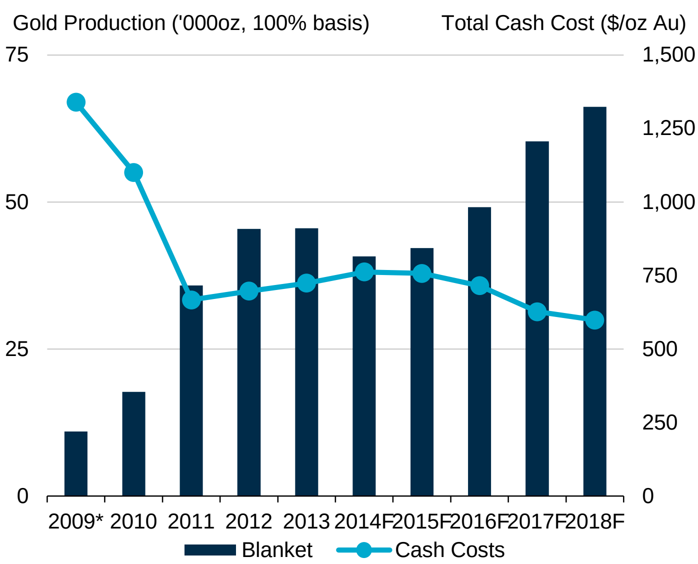


Source: Caledonia Mining Corporation (n.b. excludes dormant entities)

Production: Low-risk, Low-cost Growth

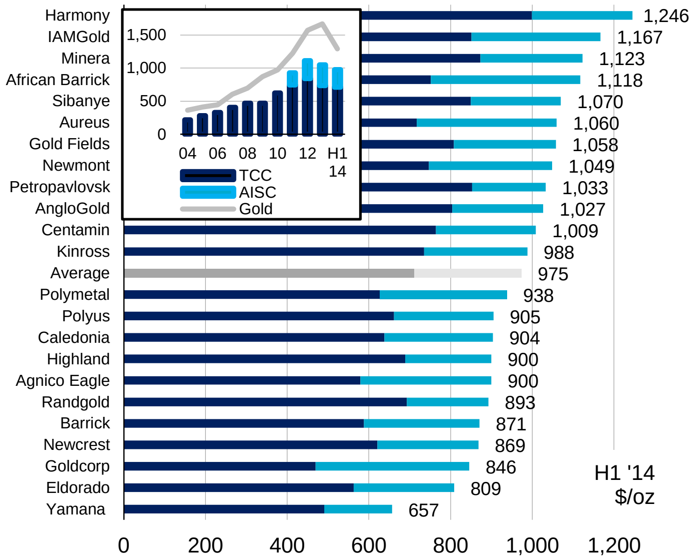
Caledonia re-started production at the Blanket mine in April 2009 and has gradually increased to around 40kozpa. In 2014, the mine struggled with grade and saw guidance downgraded twice from 48koz to 40koz (Num 41koz). With the new production plan, management expects production to increase to 75-80kozpa from 2021 by developing resources below 750m, through the No. 6 Winze and Central shaft.

Figure 4: Production & Cost Profile



Source: Caledonia Mining Corporation & Numis Securities Research

Figure 5: Peer Group Cash Cost & All-in Sustaining Cost



Source: Caledonia Mining Corporation & Numis Securities Research

Caledonia also has upside to increase production further from its satellite properties. These have potential to produce an additional 10-15kozpa to c.90kozpa from the most advanced two (GG and Mascot), according to our estimates, ramping up steadily from 2015/16. Caledonia is conservatively factoring in development expenditure into its capex budget for the satellites, but not production. We believe this means it is likely to add to the production base in some degree but the exact amount is uncertain.

Blanket is a low cost mine with total cash costs of c.$760/oz (cash operating costs of $680-700/oz exc. royalties), somewhat above the industry average of $711/oz. However, AISC is bottom quartile at c.$900/oz, below the industry average of $975/oz.

The low costs are a function of Blanket being a low infrastructure underground mine (natural ventilation and dry), with low power and labour costs and an efficient plant. As production is increased, we expect cash operating costs to fall to around $500/oz and AISC to drop to $750-800/oz, with industry/domestic inflation balanced by cost reductions and increased gold production.

Our LOM estimates are generally more conservative than company guidance, as we take into account the usual industry challenges of developing and operating mines.

Blanket: Building Growth on History

The Blanket mine is located in southwest Zimbabwe, 140km south of Bulawayo. Infrastructure is excellent with access by tarmac roads and good water sources. Power is provided from the grid, although a modern back-up generator is installed at the mine due to instability in supply. The mine employs over 900 people who live within the mine complex and are able to own trust shares in the mine through the Indigenisation structure.

We visited Blanket in January 2013 and were impressed with the set-up and hands-on management approach. We thought the operation was well run with low technical risk and lots of upside potential at low cost.

The Blanket mine has a long operating history, having started production in 1906 and produced a total of over 1Moz. Falconbridge operated the mine from 1964 to 1993, then Kinross bought it and operated at peak production of around 30-35kozpa. Caledonia purchased it in April 2006. It re-started operations in April 2009, having been temporarily shut down in the Zimbabwe turmoil.

Figure 6: View of Blanket Mine

Source: Caledonia Mining Corporation

Figure 7: Location Map

Source: Caledonia Mining Corporation

Geologically, the mine is situated on the 70km long Gwanda Greenstone belt, the second most prolific gold belt in Zimbabwe and host to around 270 gold mines. There are only three sizeable producing gold mines left on the belt: Blanket, Vubachikwe (c.15kozpa, owned by private company Clarity Capital) and Jessie (FA Stewart & Son). The mine exploits a typical Archaean greenstone-hosted gold deposit, located in a 14 ore shoots along a 3km span. Mineralisation is mainly a disseminated sulphide replacement with mining focusing on a series of shear-hosted quartz reefs, dipping steeply west.

Blanket is a conventional underground mine accessed by four vertical shafts. Only one shaft is utilised for haulage and access (No.4). Mining is currently down to 750m depth and, as a result of a shaft expansion project in late 2010, the mining rate is c.1ktpd. The mining rate is the main constraint on expanding production currently.

Mining is principally by underhand stoping, with some shrinkage and long hole stoping, where conditions warrant. The orebody is mined by conventional blasting and hand-held jack-legs. Ore is transported by rail and crushed underground before being hoisted to surface. The mine has natural ventilation, limited support (competent rocks) and is relatively dry, all helping to keep the cost base low.

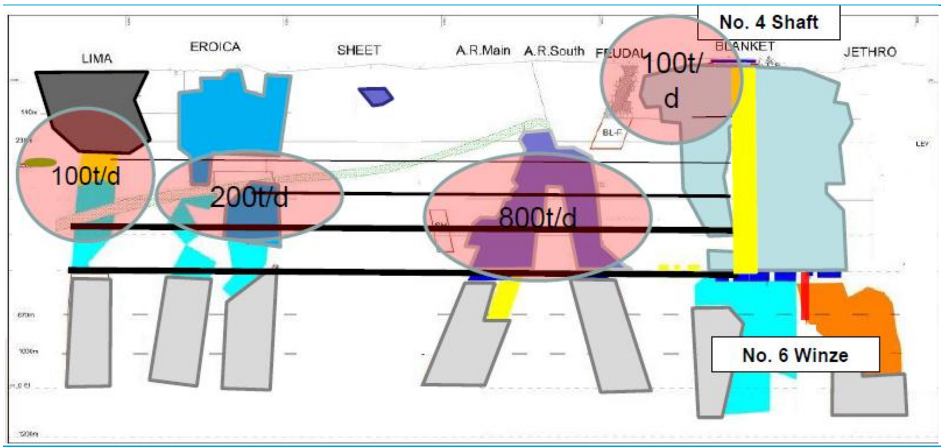
Processing is by a conventional CIL plant, with around 50% free gold recovered by gravity. Overall recovery rates are very high at around 93-94%. There is surplus plant capacity, well in excess of the 1ktpd mining rate. Current capacity comprises 3.8ktpd CIL (c.1.4Mtpa) and 2ktpd milling. Caledonia can increase crushing and milling capacity to 3.6ktpd and then 5.7ktpd (c.1.3 and 2Mtpa) with minor modifications and modest investment. Planned expansion to mining of 1.9ktpd will still leave surplus capacity in the plant, which should allow plenty of fat if needed, and could be utilised to process ore from the satellite projects and other potential ore sources.

Blanket produces dore gold bars and this is delivered and sold to Fidelity Refiners in Harare, under Zimbabwean law, for 98.5% payability.

Down-Dip Expansion: Doubling up

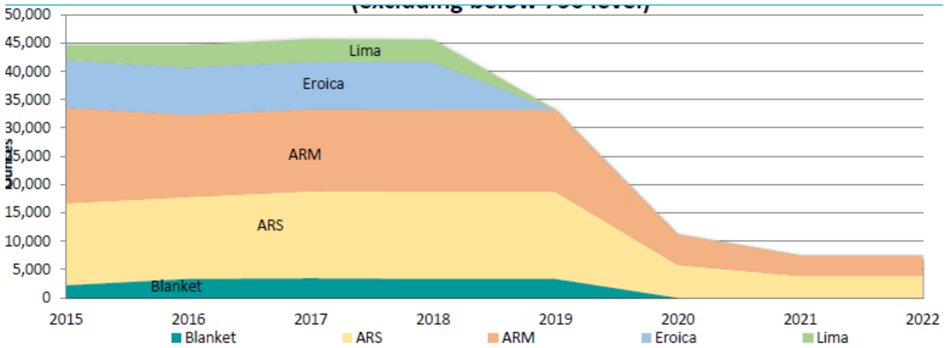
Caledonia's original plan was to increase production at Blanket to 76kozpa by 2016 at a capex of $37m. However, production above the 750m was found to be lower than expected due to internal grade dilution and lower gold prices making areas unprofitable. Plus development was slower than expected and the plan did not address logistical issues on 22L, leaving Blanket a single shaft operation with asymmetric access.

Figure 8: Current Infrastructure (No Investment)



Source: Caledonia Mining Corporation

Figure 9: Current Production Schedule (No Investment)



Source: Caledonia Mining Corporation

In November 2014, Caledonia revised its expansion plans to improve underground infrastructure and logistics and allow a more efficient and sustainable production build-up. The revised plan includes constructing a tramming loop on the 750m level and a 6m, 4-compartment central shaft, down to 1,080m depth. Caledonia undertook an internal PEA which is preliminary, based on $1,200/oz gold price, and will need inferred resources converted to reserves. Blanket has a long life so we see this as likely although the more exact numbers around grade may be difficult to ascribe at this stage.

The PEA has been reviewed by Minxcon Consulting, an independent mining consulting company. The plan will result in a more robust operation and lower costs, which is positive, plus less risk and higher project returns.

Production will be 70-75kozpa by 2021, from inferred resources; plus 6kozpa from P&P reserves. Capex will be $50m from 2015-2017; $20m from 2018-2020, all funded from internal cashflow and cash, with no recourse to equity or debt. Blanket's internal dividends and facilitation loans will be suspended.

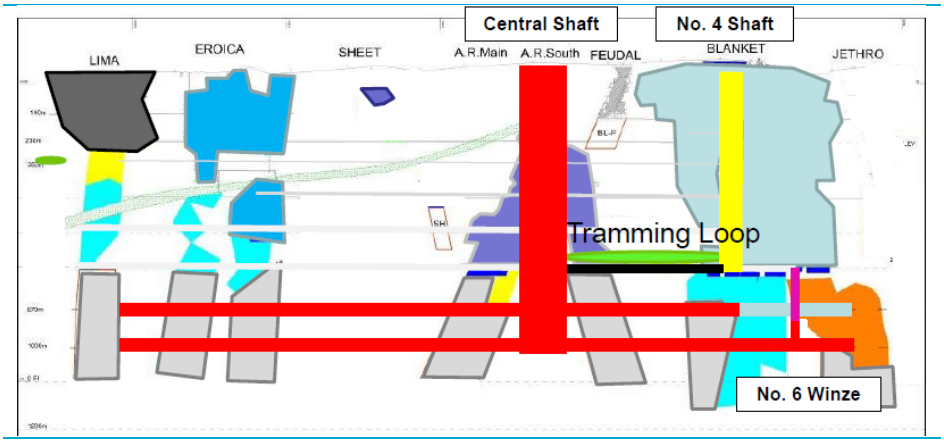
Table 6: Caledonia Projected Production

	2015	2016	2017	2018	2019	2020	2021
Tonnes Milled (kt)							
Reserves above 750m	427	455	432	384	229	97	53
Inferred resources below 750m	0	36	161	213	387	546	598
Total	**427**	**491**	**593**	**597**	**616**	**643**	**651**
Ounces Produced (koz)							
Reserves above 750m	42	45	43	39	23	10	6
Inferred resources below 750m	0	4	20	27	46	63	70
Total	**42**	**49**	**63**	**66**	**69**	**73**	**76**

Source: Caledonia Mining Corporation & Numis Securities Research

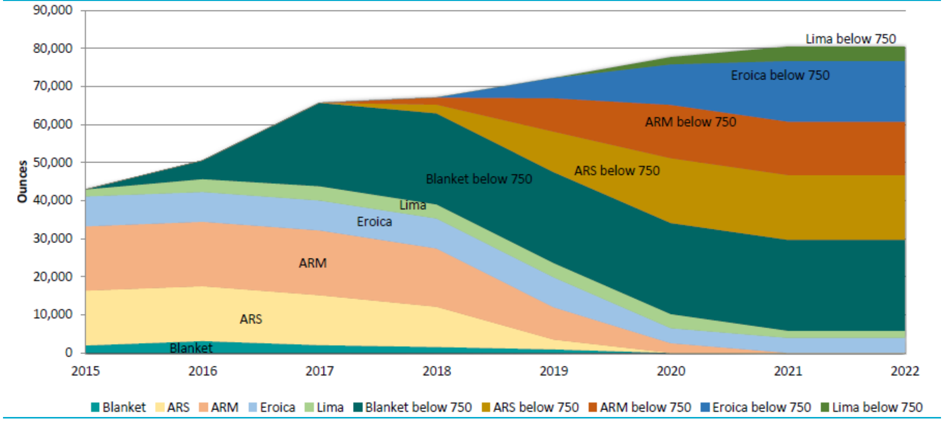
CMCL has sufficient shaft sinking experience and the benefit of a skilled Zimbabwe workforce. Blanket's indigenous investors and the Zimbabwe government are supportive of the plan. The strategy seems sensible given the current investment climate, in our view, and will make the operation more robust and bring down cash costs. The new plan has slightly higher production levels than the original plan, but slower ramp-up and higher capex with the new shaft.

Figure 10: Revised Plan (open new mining areas below 750m)



Source: Caledonia Mining Corporation

Figure 11: Revised Production Plan



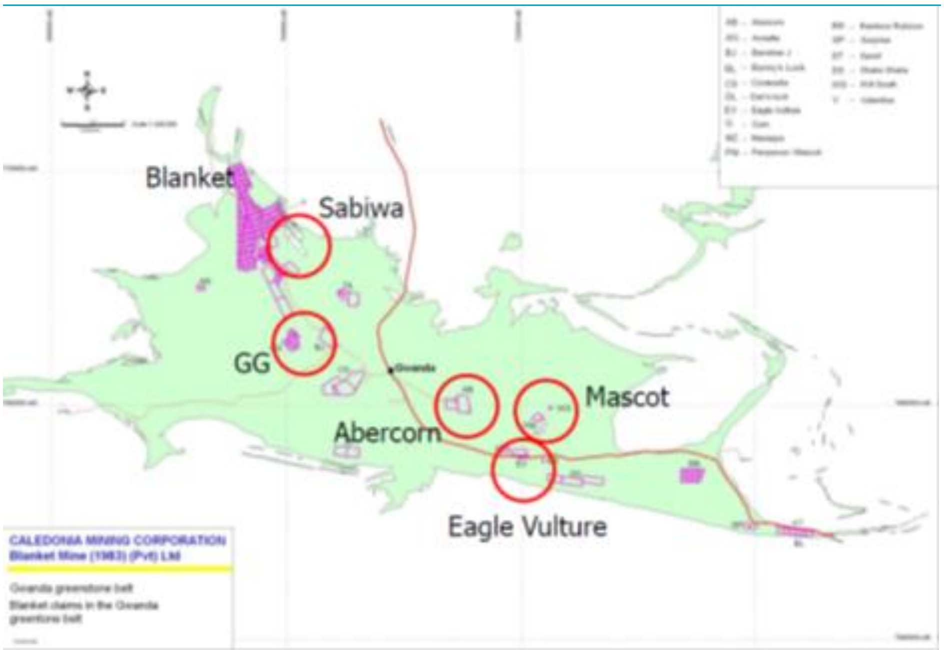
Source: Caledonia Mining Corporation

Satellite Deposits: The Upside

Caledonia holds 18 brownfield exploration licences around Blanket, which have potential to increase production by processing ore from satellite mines through the plant from H2 2015. We estimate the two most advanced projects have the **potential to add around 10-15kozpa** and provide better ore availability and grade flexibility for the Blanket operation. The satellites are likely to increase throughput, but not extend mine life. However, they are partly refractory so will impact plant recoveries. Capex is expected to be very modest, in the order of a few $m, already factored into Caledonia's expansion budget. The most advanced projects are:

- **GG** – Located 7km from Blanket. Caledonia is undertaking underground development and sinking a shaft from 120 to 240m. The company has identified two zones of mineralisation on three levels, down to 300m depth and with a 150m strike. Gold grades on a 40m x 10m envelope were 3.5g/t. Initial met testwork shows the ore as refractory.
- **Mascot** – Comprises three former operations: Mascot, Eagle Vulture and Penzance. Mascot is the furthest but most advanced project (c.40km), previously mined down to a shallow depth of 250m. Caledonia is undertaking exploration and underground development with some promising results; the mine is being dewatered to access higher grade material below current workings.

Figure 12: Satellite Location Map



Source: Caledonia Mining Corporation

Financials: Generating Cash

We expect 2015 earnings and cashflow to be relatively flat, before picking up in 2016 and a substantial increase in 2017 as the Central Shaft is sunk and the cost base begins to fall dramatically. We forecast an EPS of 10c in 2014, rising to 17c in 2016 (NPAT C$9m). We expect EBITDA to grow from C$14m to C$19m, based on our flat gold price assumptions. We expect the indigenisation agreement to kick in past 2021, when we should see profits come away.

In our view, Caledonia has a decent balance sheet with cash of C$28m (Sept 2014). The company has not raised any equity since 2008, highlighting its conscious effort to preserve shareholder value. The company has a $2.5m loan facility in Zimbabwe, with $0.9m drawn.

Caledonia's expansion plan is for $50m capex spend in 2015-2017 (peak in 2016 at $18m) and $20m in 2018-2020. The Central Shaft is the bulk of the budget at $21m. Based on our flat gold price assumptions we see the cash balance falling to c.$10m. Given the conservative nature of the business, we expect the balance sheet to be well managed and project strong cash generation as the capex is spent.

Caledonia gets paid in USD by Fidelity Refineries to its Zimbabwe bank account. It then transfers funds out of country, keeping the majority of its cash offshore (UK, Canada and South Africa). Since Zimbabwe adopted the USD, plus relaxed controls on flows of funds, the financial risk of this process has been somewhat mitigated, in our view.

In November 2012, Caledonia announced a maiden dividend of 5c/sh (post-consolidation basis) and a further 5c/sh further dividend in April 2013. The company is keen to distribute cash to shareholders, provided it does not impinge on the growth plans. It is paying a 6c/sh dividend in 2014 (paid quarterly), which it intends to continue through 2015. Given the forecast profitability, we see this continuing at similar levels. We have assumed a conservative 15% payout ratio in our model, equivalent to an 8% yield.

On 12 April 2013, Caledonia completed a 10:1 share consolidation and now has 52m shares in issue.

Figure 13: Model Summary

Caledonia Mining	Ticker	CMCL.L	Market Capitalisation	£21m	Financial Year End	Dec
BUY	Share Price	£0.40	Enterprise Value (EV)	£7m	Reporting Currency	C$
£0.75	Implied Return	90%	Net Debt (Cash)	-$24m	Shares in Issue	52m

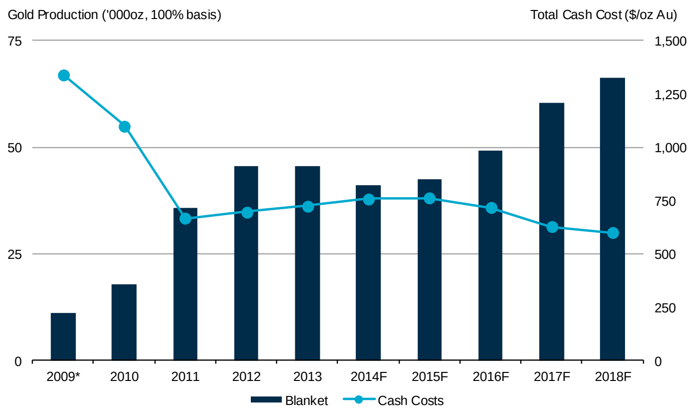
Valuation					
Net Asset Value	**Disc Rate**	**NAV (%)**	**$m**	**$/sh**	**£/sh**
Blanket (49%)	14%	107%	100	1.82	1.02
Exploration Properties		0%	0	0.00	0.00
Sub-total			**100**	**1.82**	**1.02**
Cash & Equivalents		27%	25	0.46	0.26
Debt		(1%)	(1)	(0.02)	(0.01)
Corporate G&A / Other		(33%)	(31)	(0.56)	(0.32)
Total			**93**	**1.70**	**£0.95**
Current NAV Multiple (Implied)					0.41x
Cash Flow Value				**$/sh**	**£/sh**
CFPS (1 year forward)				0.19	0.11
Current P/CF multiple (implied)					3.7x
Blended Valuation			Target Multiple	Weight	
NAV valuation			1.00x	50%	£0.95
Cash Flow valuation			5.0x	50%	£0.54
VALUATION					**£0.75**

Sensitivity Analysis	NAV (£/sh)	15F EPS	15F CFPS
Base case gold price forecast	0.95	0.09	0.17
Base case +10%	1.15	0.15	0.24
Base case -10%	0.77	0.03	0.10
Flat gold price (at spot $1,150/oz)	0.92	0.06	0.13

	H1 15	H2 15	2016	2017
Tramming loop on 750m level				
Start Sinking Central Shaft (800tpd)				
No. 6 Winze Project (500tpd) starts production				
Mining of AR Main/South below 750m starts				
Complete Central Shaft				H2

Reserves & Resources (attributable)		Tonnage	Grade	Gold	EV/oz
Reserves (P&P)	Moz	3	3.7	0.4	17
Resources (M&I)	Moz	0	3.8	0.1	125
Resources (Total)	Moz	7	4.2	0.9	7

Production & Cost		2013	2014F	2015F	2016F
Gold Production	000oz	46	41	42	49
Gold Production (attributable)	000oz	22	20	21	24
EV/oz Production (attributable)	$/oz Au	309	343	332	286
Cash Operating Cost	$/oz	613	666	695	650
Total Cash Cost (net by-products)	$/oz	724	758	760	718
All-in Sustaining Cost	$/oz	977	954	966	903



Assumptions (Real)	2013	2014F	2015F	2016F	LT
Gold Price ($/oz)	1,412	1,266	1,200	1,200	1,200
Exchange Rate (US$:£)	1.56	1.66	1.62	1.62	1.62
Exchange Rate (C$:US)	0.97	0.91	0.91	0.91	0.91

Key Metrics	2012	2013	2014F	2015F	2016F
EPS (Adjusted, $/sh)	0.50	0.28	0.10	0.09	0.17
EPS Growth	1914%	-43%	-66%	-7%	88%
P/E	1.4x	2.5x	7.4x	8.0x	4.3x
CFPS ($/sh)	0.06	0.28	0.27	0.17	0.27
P/CFPS	12.2x	2.5x	2.6x	4.2x	2.6x
FCFPS ($/sh)	0.04	0.06	0.14	(0.15)	(0.11)
P/FCFPS	16.6x	12.4x	5.0x	n.m	n.m
FCF Yield	6%	8%	20%	-21%	-15%
EV/EBITDA	0.5x	1.0x	0.8x	1.0x	0.6x
EBITDA Margin	32%	20%	28%	22%	29%
Dividend Per Share ($/sh)	0.00	0.05	0.08	0.05	0.05
Dividend Yield	0.0%	7.8%	10.7%	7.7%	7.7%
Return on Assets (ROA)	10%	-4%	8%	6%	10%
Return on Equity (ROE)	15%	-11%	7%	5%	9%
Return on Capital Employed (ROCE)	33%	15%	17%	12%	20%
Net Debt/EBITDA	-1.2x	-1.8x	-1.7x	-1.3x	-0.4x
Gearing (Debt/Equity)	0%	3%	0%	0%	0%
Interest Cover	-0.1x	0.0x	0.0x	0.0x	0.0x
Shares Outstanding (m)	514	52	52	52	52

Income Statement	2012	2013	2014F	2015F	2016F
Revenue	75	65	57	55	67
Cost of Sales	(31)	(32)	(35)	(36)	(40)
G&A	(19)	(8)	(7)	(7)	(7)
Exploration	0	0	0	(0)	(0)
Other	(2)	(13)	1	0	0
EBITDA	**24**	**13**	**16**	**12**	**19**
DD&A	(3)	(3)	(4)	(4)	(4)
EBIT	**21**	**10**	**12**	**8**	**16**
Net Interest Expense	(2)	(0)	(0)	0	0
PBT	**19**	**9**	**12**	**9**	**16**
Non-Recurring Items/Other	1	(3)	(2)	(1)	(2)
Taxes/Recovery	(13)	(10)	(4)	(3)	(5)
Net Profit (Loss) - attributable	**7**	**(3)**	**6**	**5**	**9**
Minority Interest	(1)	3	2	1	2

Cashflow	2012	2013	2014F	2015F	2016F
Net Profit (Loss)	6	(0)	7	6	11
DD&A	3	3	4	4	4
Non Recurring/Other	29	25	4	2	5
Working Cap. Changes	3	(5)	3	(1)	(1)
Cash Flow From Operations	**30**	**15**	**14**	**9**	**14**
Capital Expenditure	(8)	(12)	(7)	(16)	(19)
Acquis./Investments	0	0	0	0	0
Cash Flow From Investing	**(8)**	**(12)**	**(7)**	**(16)**	**(19)**
Equity Issues (Net of Costs)	1	0	0	0	0
Net Borrowings	(0)	0	(1)	0	0
Dividends Paid & Other	(4)	(8)	(4)	(3)	(3)
Cash Flow From Financing	**(3)**	**(7)**	**(5)**	**(3)**	**(3)**
Net Change in Cash	18	(5)	2	(10)	(8)
Free Cash Flow	**22**	**3**	**7**	**(8)**	**(6)**

Balance Sheet	2012	2013	2014F	2015F	2016F
Cash & Equivalents	**28**	**25**	**27**	**16**	**8**
Total Current Assets	35	36	35	27	21
PP&E & Mining Interests	36	33	38	50	66
Deferred taxation	0	0	0	0	0
Other	0	0	0	0	0
Total Assets	**72**	**70**	**73**	**78**	**87**
Short Term Debt	0	2	0	0	0
Current Liabilities	9	8	5	6	7
Long Term Debt	0	0	0	0	0
Other Long Term Liabilities	7	10	10	10	10
Total Liabilities	**16**	**18**	**16**	**17**	**17**
Shareholder Equity	56	52	58	61	69
Total Liab. & S/Holder Equity	**72**	**70**	**73**	**78**	**87**
Working Capital	26	29	30	21	14
Net Debt (Cash)	**(28)**	**(23)**	**(27)**	**(16)**	**(8)**

Source: Caledonia Mining Corporation & Numis Securities Research

Valuations

We value gold/silver producers at 1-2x P/NAV and 5-15x 1 year forward P/CF; gold pre-producers at 0.5-1x P/NAV, based on historic trading ranges.

- **African Barrick Gold:** 1.5x P/NAV, 5x P/CF (mid). An established mid-tier producer with strong production profile and balance sheet, offset by operational difficulties and political risk.
- **Aureus**: 1x P/NAV, 5x P/CF (bottom). Emerging junior producer with project delivery and political risk.
- **Caledonia:** 1x P/NAV, 5x P/CF (bottom). Profitable junior producer with a solid, low-cost production base and healthy growth profile, offset by high political risk in Zimbabwe.
- **Centamin Egypt:** 1x P/NAV, 5x P/CF (bottom). Mid-tier producer with high Egyptian political risk.
- **Chaarat Gold:** 0.75x P/NAV (mid). Feasibility stage explorer with risks around permitting, financing and construction.
- **Condor Gold**: 0.75x P/NAV (mid). PFS stage explorer with risks around permitting, financing and construction.
- **Fresnillo:** 2x P/NAV, 15x P/CF (top). Premier major producer with good track record, strong production profile and sound balance sheet.
- **Highland Gold:** 1.25x P/NAV, 5x P/CF (lower end). Established junior producer with a solid production base, healthy growth profile and sound balance sheet, offset by Russian political risk.
- **Hochschild Mining:** 1.75x P/NAV, 7.5x P/CF (upper end). Good track record but low margin business.
- **Minera**: 1x P/NAV (lower end). Established junior producer with growth, offset by financing and project development risk.
- **Petropavlovsk:** 1.5x P/NAV, 5x P/CF (bottom). Established mid-tier gold producer with mixed track record, high debt plus technical and Russian political risk.
- **Randgold:** 2x P/NAV, 15x P/CF (top). Major gold producer with excellent track record, strong production profile and sound balance sheet.

Risks

- **Commodity prices:** The future price realisable for the company's product will have a significant effect on the future profitability of the company. Some companies will use hedging to mitigate some of this risk, although most prefer to retain full upside exposure to the underlying commodity. Some companies have diversified production from a number of metals, which helps to mitigate the risk of a price decline in any one commodity. A downturn in commodity prices may lead to lower investment in the industry, which may impact on a company’s earnings and/or growth potential.
- **Costs:** Cost inflation above our assumptions could have a greater than anticipated impact on group earnings. The cost of raw materials, power and labour are often dependent on factors outside the company’s control. Mining costs are highly dependent on factors such as rock strength and characteristics, as well as the mining method.
- **Production & construction:** All mines have risk of disruption to production due to unforeseen issues regarding health and safety, geology and engineering. Risks to production forecasts can come from delays in the commissioning process for a new project. There are risks to production from the application of new technology that may not perform within the design criteria.
- **Political & logistics:** Mining companies operate globally and often in areas of high political risk. Changes to the government and/or legislation may impact production and/or earnings in future years. The supply of materials, plant, equipment and personnel may be affected by local issues beyond the company’s control. Some countries may be more challenging in this respect than others.
- **Personnel:** The success of an operation and/or company often depends on key management and/or highly skilled operations staff, who may be in short supply and/or leave the employ of the company. This may impact operations and/or future growth prospects. Management expertise may also become stretched if the company attempts to grow too rapidly.
- **Geological**: Reserve and resource estimates are subject to statistical uncertainty, and as such carry a risk that earnings could be significantly affected by unexpected changes in throughput, grade and cost.
- **Financing:** Mining is often highly capital intensive. There is often a risk, especially with a development company, that the necessary debt and/or equity funding may not be available, or may be detrimental to the project economics.
- **Permitting:** Significant delays to the permitting processes could have a material impact on development projects.
- **Environmental:** Mining carries a risk of damage to the environment and consequent risk of litigation.
- **Currency & inflation:** Variations in the local exchange rate versus the currency in which revenues are paid (usually US Dollars) can impact earnings significantly. This has been a particular problem with South African based operations in recent years.

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Add	> +10% to +19.99%
Hold	0% to +/-9.99%
Reduce	-10% to -19.99%
Sell	> -20%

With effect from 9 February 2010 upon the initial establishment of a recommendation and target price for a company, an additional 10 % deviation in the price from the default bands set out above is permitted before the recommendation has to be changed in subsequently published research documents.

Distribution of Ratings

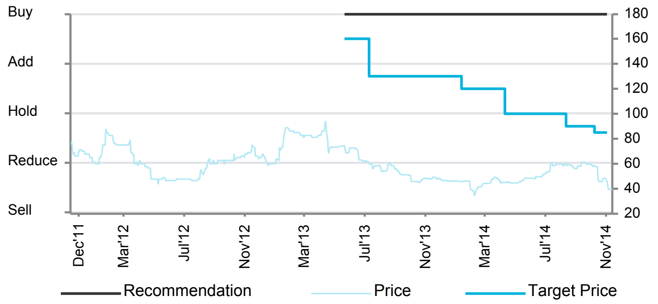
	US Requirement 01/10/2013 - 30/09/2014		UK Requirement 01/07/2014 - 30/09/2014	
	All Securities	**Corporate Clients**	**All Securities**	**Corporate Clients**
Buy	42.7%	72.4%	44.2%	71.6%
Add	21.5%	16.5%	21.8%	16.7%
Hold	31.5%	11.0%	29.7%	11.6%
Reduce	2.7%	0.0%	2.7%	0.0%
Sell	1.6%	0.0%	1.5%	0.0%
Total	100%	100%	100%	100%
	The above table shows the split of recommendations based on the last recommendation for each research stock during the last four calendar quarters.		The above table shows the split of recommendations based on all recommendations during the last calendar quarter for all securities and within each category the proportion of issuers to which Numis supplied material banking services.	

For the split of recommendations by sector for the period from 1 Oct 2013 to 30 Sep 2014, please contact the Research Department of Numis Securities Ltd.

The following graphs display the three year recommendation, target price and share price history for the subject corporation(s) of this research report. In those instances where the subject corporation(s) have been traded on the London Stock Exchange or Alternative Investment Market for less than three years, the graph will show the history since the date the subject corporation(s) were admitted to trading. Prices in the graph(s) below are in pence unless otherwise stated.

Three Year - Recommendation, Target Price, Share History

Caledonia Mining Corp



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