chalice
GOLD MINES

REGISTERED OFFICE

Level 2/1292 Hay Street
West Perth, Western Australia 6005

GPO BOX 2890
Perth, Western Australia 6001

T: +618 9322 3960
F: +618 9322 5800

E: info@chalicegold.com
W: www.chalicegold.com

Dear Shareholder

**Proposed Sale of the Zara Project**

On 27 April 2012 Chalice announced that it had entered into a conditional agreement to sell its remaining 60 per cent interest in the Zara Project in Eritrea to China SFECO Group ("**SFECO Transaction**").

The Agreement with SFECO follows the agreement in July 2011 pursuant to which Chalice agreed to sell a 30 per cent interest in the Zara Project to the Eritrean National Mining Corporation ("**ENAMCO**"); ENAMCO has a 10 per cent carried interest in the Zara Project. The consideration under the SFECO Transaction is US$80M and under the ENAMCO Transaction approximately US$34 million, of which US$3 million was paid in January 2012.

The transaction with ENAMCO is to be completed simultaneously with the SFECO Transaction which, subject to satisfaction of certain conditions, we anticipate to be mid to late July 2012.

One of the conditions of the SFECO Transaction is Chalice Shareholder approval which is the subject of the Resolution in the attached Notice of Meeting.

Further details of the SFECO Transaction are set out in the Explanatory Statement accompanying this Notice of Meeting.

To assist Shareholders to assess the merits or otherwise of the SFECO Transaction, the Directors commissioned Ernst & Young Transaction Advisory Services Limited ("Ernst & Young" or the "Expert") to provide an independent expert's report as to whether the SFECO Transaction was, in the opinion of the Expert, fair and reasonable and in the best interests of Shareholders. That report accompanies this Notice of Meeting.

**In the opinion of Ernst & Young, the SFECO Transaction is not fair but reasonable to Chalice Shareholders and, having regard to the nature of the SFECO Transaction and the advantages and disadvantages, Chalice Shareholders are likely to be better off if the SFECO Transaction proceeds as opposed to it not proceeding.**

As Shareholders will note, in arriving at its opinion Ernst & Young engaged CSA Global Pty Ltd ("CSA") to undertake an independent technical review of the Feasibility Study on the Koka Gold Deposit and report to Ernst & Young on issues of a technical, operational or capital cost nature. In addition, CSA was also requested to provide a valuation on the exploration potential of the area outside of the Koka Gold Deposit.

Since SFECO approached Chalice about acquiring the Zara Project, the Directors have given a great deal of thought and consideration to the SFECO Transaction and concluded that acceptance and completion of the SFECO Transaction would be in the best interests of Shareholders. Further detail on the matters taken into consideration is set out in the Explanatory Statement accompanying the Notice.

Completion of the SFECO and ENAMCO Transactions will deliver a number of key benefits to Chalice Shareholders including:

1. Realisation of a significant cash return for the Zara Project at a premium to Chalice's share price prior to the announcement of the SFECO Transaction. The Company expects to have cash of more than $80 million which equates to a cash backing of around 34 cents per share.

2. Avoiding the necessity for a potentially dilutive capital raising to fund Chalice's share of development of the Koka Gold Mine.

3. As a single asset company, monetising the asset now and avoiding development risks.

4. Placing Chalice on a sound financial footing and with a significant uncommitted cash balance, so it is well positioned to pursue other opportunities in the mining sector.

**For the reasons outlined above and in more detail in the attached Explanatory Statement, the Directors of Chalice unanimously recommend that Shareholders vote in favour of the Resolution to sell its remaining interest in the Zara Project.**

Upon completion of the SFECO and ENAMCO Transactions, the Company will turn its attention to seeking other investment opportunities in the resource sector. In addition, exploration will continue at the Company's Mogoraib North and Hurum Projects in Eritrea (owned 60 per cent by Chalice and 40 per cent by ENAMCO). The Mogoraib North Project lies just north of the world-class Bisha Mine owned by Nevsun Resources Limited and ENAMCO and at which the Company is targeting Volcanic Hosted Massive Sulphide deposits similar to the Bisha deposit.

The sale of the Zara Project represents a significant opportunity for the Company, and all Shareholders are encouraged to vote at the meeting by submitting a proxy voting form or attending in person or by corporate representative. Shareholders voting by proxy must have their proxy forms submitted and received by the Company by no later than 10am (WST) on 28 June 2012.

This Notice of Meeting including the Explanatory Statement and the Ernst & Young Report are important documents and I encourage you to read them in their entirety and, if required, obtain advice from your professional adviser.

Yours faithfully

TIM GOYDER
Executive Chairman

# CHALICE GOLD MINES LIMITED

**A B N 4 7 1 1 6 6 4 8 9 5 6**

# NOTICE OF GENERAL MEETING, EXPLANATORY STATEMENT AND PROXY FORM

## To be held on 29 June 2012

## At 10 am (Australian WST)

**Middletons**
**Level 32, 44 St Georges Terrace**
**Perth**
**Western Australia**

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## TIME AND PLACE OF MEETING AND HOW TO VOTE

### VENUE

The General Meeting of the Shareholders of Chalice Gold Mines Limited ('**Chalice**') to which this Notice of Meeting relates will be held at 10am (WST) on 29 June 2012 at Middletons, Level 32, 44 St Georges Terrace, Perth, Western Australia.

### YOUR VOTE IS IMPORTANT

The business of the Meeting affects your shareholding and your vote is important.

### VOTING IN PERSON

To vote in person, attend the Meeting on the date and at the place set out above.

### VOTING BY PROXY

All Shareholders who are entitled to attend and vote at the Meeting have the right to appoint a proxy to attend and vote for them. The proxy does not have to be a Shareholder. Shareholders holding two or more Shares can appoint either one or two proxies. If two proxies are appointed, the appointing Shareholder can specify what proportion of their votes they want each proxy to exercise.

To vote by proxy, please complete and sign the proxy form enclosed and either send it:

(a) by post to Chalice Gold Mines Limited, GPO Box 2890, Perth, WA, 6001; or

(b) by facsimile to the Company on + 61 8 9322 5800,

so that it is received no later than **10am (WST) on 28 June 2012**, being not less than 48 hours prior to the commencement of the Meeting. Proxy forms received later than this time will be invalid. Where the proxy form is executed under power of attorney, the power of attorney must be lodged in the same way as the proxy form.

### BODIES CORPORATE – CORPORATE REPRESENTATION

A body corporate may appoint an individual as its representative to exercise any of the powers the body may exercise at the meeting of shareholders. The appointment may be a standing one. An Appointment of Corporate Representative is enclosed with this Notice.

## VOTING ENTITLEMENTS

The Board has determined that, for the purpose of voting at the Meeting, Shareholders are those persons who are the registered holders of the Company's shares at 5pm (WST) on 27 June 2012.

## ENQUIRIES

The Company welcomes enquiries in respect of matters covered in this Notice of Meeting and Explanatory Statement and the attendance of Shareholders at the Meeting. Should you require further information please contact:

The Company Secretary
Richard Hacker
Phone: (+61 8) 9322 3960
Fax: (+61 8) 9322 5800
Email: rhacker@chalicegold.com

## NOTICE OF GENERAL MEETING

**NOTICE IS GIVEN** that a General Meeting (**Meeting**) of the Shareholders of Chalice Gold Mines Limited (the **Company**) will be held at Middletons, Level 32, 44 St Georges Terrace, Perth, Western Australia on 29 June 2012 at 10am (WST).

**AGENDA**

**RESOLUTION – DISPOSAL OF CHALICE'S 60 PERCENT INTEREST IN THE ZARA PROJECT**

To consider and, if thought fit, to pass as an ordinary resolution:

> *"That, for the purposes of ASX Listing Rule 11.2 and for all other purposes, approval is given for the sale by Chalice Gold Mines (Eritrea) Pty Ltd (being a wholly owned subsidiary of Chalice Gold Mines Limited) of all its shares in Zara Mining Share Company (owner of the Zara Project in Eritrea) to Shanghai Construction (Hong Kong) Limited, a wholly-owned subsidiary of China SFECO Group, on the terms and conditions set out in section 1.1 (b) of the Explanatory Statement, representing the Company's 60 per cent interest in the Zara Project."*

**Voting Exclusion Statement**

The Company will disregard any votes cast on this Resolution by a person who might obtain a benefit, except a benefit solely in the capacity of a holder of ordinary securities in the Company if the Resolution is passed and any of their associates.

However the Company need not disregard a vote if:

(a) it is cast by that person as proxy for a person who is entitled to vote, in accordance with the directions on the proxy form; or

(b) it is cast by the chairman of the meeting as proxy for a person who is entitled to vote, in accordance with a direction on the proxy form to vote as the proxy decides.

By order of the Board

Company Secretary
21 May 2012

# EXPLANATORY STATEMENT

This Explanatory Statement has been prepared for the information of the Shareholders in connection with the business to be conducted at the Meeting of Chalice Gold Mines Limited (**Chalice**) to be held at Middletons, Level 32, 44 St Georges Terrace, Perth, Western Australia on 29 June 2012 at 10am (WST).

The purpose of this Explanatory Statement is to provide information which the Directors believe to be material to Shareholders in deciding whether or not to pass the resolution in the Notice of Meeting.

## RESOLUTION – APPROVAL FOR THE DISPOSAL OF CHALICE'S 60 PER CENT INTEREST IN THE ZARA PROJECT

### 1.1 Overview of the Transaction

***(a) Background***

On 27 April 2012, Chalice (and its wholly owned subsidiary Chalice Gold Mines (Eritrea) Pty Ltd) entered into a conditional agreement (**SFECO Agreement**) with Shanghai Construction (Hong Kong) Limited and China SFECO Group, both subsidiaries of Shanghai Construction Group Co Ltd and referred to in this Notice as **SFECO**, to sell its remaining 60 percent interest in ZMSC (**the SFECO Transaction**). The material terms of the SFECO Agreement are set out below.

The SFECO Agreement supersedes the Heads of Terms with SFECO dated 26 December 2011 (**Heads of Terms**).

ASX Listing Rule 11.2 provides that an entity is to seek the approval of its Shareholders before disposing of its main undertaking. The SFECO Transaction, which if completed, will see the disposal by the Company of its main undertaking, being its 60 per cent interest in the Zara Project.

The SFECO Transaction is conditional upon such approval.

The SFECO Agreement follows the agreement in July 2011 pursuant to which Chalice agreed to sell a 30 per cent interest in the Zara Project to ENAMCO for US$32 million plus approximately US$2 million in reimbursable expenditures (the ENAMCO Transaction). This 30 per cent is in addition to the 10 per cent carried interest in the project already held by ENAMCO. US$3 million of the agreed consideration was paid by ENAMCO in January 2012 in consideration of Chalice agreeing to extend the time for completion of the ENAMCO Transaction.

As noted below, the consideration payable under the SFECO Transaction is US$80 million paid as to US$78 million on settlement and US$2 million on first gold pour at the Koka Gold Mine.

The ENAMCO Transaction is to be completed simultaneously with the SFECO Transaction which, subject to satisfaction of the conditions described below, should be around mid to late July 2012.

Completion of the SFECO Transaction will end Chalice’s involvement with the Zara Project; however, subject to positive exploration results, Chalice will maintain an active presence in Eritrea with its Mogoraib North and Hurum Projects (owned 60 per cent by Chalice and 40 per cent by ENAMCO). The Mogoraib North Project lies about 100km south of the Zara Project and immediately north of the Bisha Mine (jointly owned as to 60 per cent TSX listed Nevsun Resources and 40 per cent ENAMCO).

### *(b) Material Terms of the SFECO Agreement*

The sale price for the 60 per cent interest Chalice is selling under the SFECO Transaction is US$80 million, of which US$78 million is payable on settlement and US$2 million upon the date that gold is first commercially produced from the Koka Gold Mine.

Under the Heads of Terms, which was subject, amongst other things, to SFECO's due diligence and in country investigations, a price of US$80 million was payable for the Koka Gold Deposit and Chalice Shareholder Loans plus a further sum, for the balance of the area falling within the Zara Project to be agreed or failing agreement determined by an independent expert. This further sum was capped at US$20 million.

Following SFECO's due diligence, SFECO advised it was only prepared to pay an all up figure (for the Koka Gold Deposit and the surrounding area) and less than that contemplated under the Heads of Terms. Following further negotiations, Chalice and SFECO agreed an all up figure of US$80 million subject to satisfaction of conditions set our below.

US$7,410,647 of the sale price is attributed to the purchase of the Chalice Shareholder Loans. The balance of the sale price is attributed to the purchase of Chalice's shares in ZMSC held by Chalice Gold Mines (Eritrea) Pty Ltd.

In addition to the payment on settlement, SFECO is to reimburse Chalice all operating expenses incurred in the ordinary course of business in relation to the Zara Project funded by Chalice in respect of the period 1 December 2011 until settlement. This is estimated to be approximately US$700,000 (subject to audit).

The SFECO Agreement is subject to the following conditions being fulfilled by 26 July 2012 (or such later date as Chalice and SFECO agree):

(i) Chalice's Shareholders approving the SFECO Transaction;

(ii) SFECO obtaining the necessary regulatory approvals within China, including from the National Development and Reform Commission, the Ministry of Commerce, the State Asset Supervision and Administration Commission and the State Administration of Foreign Exchange;

(iii) Chalice Gold Mines (Eritrea) Pty Ltd delivering a certificate confirming the warranties at completion;

(iv) SFECO providing satisfactory evidence to ENAMCO that it has the necessary technical and financial resources to meet the obligations of Chalice under the shareholders agreement in respect of ZMSC as between Chalice and ENAMCO and is of good standing and reputation, and SFECO entering into a shareholders agreement with ENAMCO in the same terms as that shareholders agreement or such other legal document satisfactory to ENAMCO and SFECO entering into all other agreements or deeds necessary for the purposes of assuming the other obligations of Chalice Gold Mines (Eritrea) Pty Ltd in respect of the Zara Project;

(v) SFECO demonstrating to the satisfaction of the Minister of Energy and Mines of the Government of Eritrea, that it has access to the requisite financial and technical resources and expertise to carry out the operations under the mining agreement and exploration agreements for the Zara Project and obtaining of the approval of the Minister under such agreements;

(vi) completion of the ENAMCO Transaction on terms satisfactory to Chalice;

(vii) Chalice transferring to ZMSC all licences and other rights or assets which the Chalice group may hold which relate to the Zara Project;

(viii) ZMSC not having any loans or other liabilities to Chalice other than the Chalice Shareholder Loans and in relation to the operating expenses referred to above which are to be reimbursed on completion;

(ix) ZMSC having successfully obtained a business licence and tax registration in Eritrea;

(x) the Exploration Licenses for Zara Central (comprising Zara 1, 2, 3 and 4) having been renewed;

(xi) and certain environmental plans being approved by Eritrean authorities on a basis acceptable to SFECO acting reasonably and in good faith; and

(xii) there not having occurred any event of force majeure.

The conditions in (vi) to (ix) above either have been satisfied or are anticipated to be satisfied in the short term.

SFECO is in the process of obtaining the approvals referred to in (ii) above and there has been no notification of any force majeure as referred to in (x) above. In relation to the condition in (v), the initial completion date for the ENAMCO Transaction was 26 January 2012, but by agreement, and in consideration of ENAMCO making an interim payment of US$3 million on account of the consideration, the completion date has been extended to occur at the same time as completion of the SFECO Transaction.

If any conditions are not satisfied by 26 July 2012 (or such later date as Chalice and SFECO may agree), the SFECO Agreement will terminate. Chalice is not obliged to complete the SFECO Transaction unless the ENAMCO Transaction also completes.

The SFECO Agreement provides that Chalice shall not solicit or be involved in discussions or negotiations concerning the sale of its shares in ZMSC until completion, but this is subject to a carve out allowing the Chalice directors to discharge their fiduciary and statutory duties in the event of a superior proposal. In these circumstances, a 'break fee' of 1 per cent of the consideration is payable to SFECO on termination.

The SFECO Agreement also contains the usual indemnities and warranties expected in a transaction of this nature and pre-completion requirements. Chalice's liability for a breach of warranty is limited to the consideration (plus costs).

***(c) Completion of SFECO Transaction***

Completion of the SFECO Transaction is anticipated to occur on or around mid to late July 2012 subject to completion of the conditions. If the conditions are satisfied earlier, then completion will take place earlier.

Chalice will be liable to pay profits tax to the Eritrean Government on proceeds from the SFECO Transaction and the ENAMCO Transaction at a rate of 38 per cent less allowable previous expenditures. It is anticipated that the tax on both Transactions will total approximately US$26 million (~A$25 million).

In addition to these tax payments, on completion of the SFECO Transaction, Chalice will pay Dragon Mining Limited A$1.5 million in full consideration for the 'trailing payment' of A$4 million that would become payable in the event a 1 million ounce ore reserve was delineated at the Zara Project. This 'trailing payment' was a term of the purchase by Chalice of Dragon Mining Limited's 20 per cent interest in the Zara Project in June 2010.

On completion of the SFECO and ENAMCO Transactions the Company will realise estimated net proceeds as follows:

| | US$ |
|---|---:|
| Sale price – SFECO Transaction (1) | 78,000,000 |
| Sale price – ENAMCO Transaction (2) | 34,000,000 |
| Reimbursement of operating expenses | 700,000 |
| Less: | |
| Eritrean tax (estimate only) | (25,700,000) |
| Payment to Dragon Mining (3) | (1,545,000) |
| Net proceeds from transactions after tax | 85,455,000 |

Notes:

(1) A further US$2 million is payable on first gold pour.

(2) US$3 million has already been received from ENAMCO.

(3) The payment to Dragon Mining Limited is denominated in A$. An exchange rate of A$1.036: US$1.00 has been used.

Pro forma balance sheets setting out the financial position of Chalice at completion of the SFECO Transaction and the ENAMCO Transaction are set out in section 1.8 including the Company's anticipated post-tax cash position.

## 1.2 Independent Expert's Report

Whilst the SFECO Transaction is conditional upon Chalice shareholder approval, the provision of an independent expert's report to Shareholders is not specifically required under either the Corporations Act or the ASX Listing Rules. Notwithstanding this, the Directors of Chalice thought it appropriate to provide Shareholders with such a report and to that end commissioned Ernst & Young Transaction Advisory Services Limited (**Ernst & Young**) to prepare an expert's report to assist Shareholders in considering the merits of the SFECO Transaction.

The Independent Expert's Report accompanies this Notice of Meeting and in which Ernst & Young have set out their valuation conclusions. Ernst & Young have also set out the commercial and qualitative factors relevant to the consideration for the SFECO Transaction as they see them.

To assist it in arriving at its opinion Ernst & Young engaged CSA Global Pty Ltd (**CSA**) to undertake an independent technical review of the Feasibility Study and report to Ernst & Young on issues of a technical, operational or capital cost nature. In addition, CSA were also requested to provide a valuation on the exploration potential of the area outside of the Koka Gold Mine.

**IN THE OPINION OF ERNST & YOUNG, THE SFECO TRANSACTION IS NOT FAIR BUT IS REASONABLE TO CHALICE SHAREHOLDERS AND IN ERNST & YOUNG'S OPINION, HAVING REGARD TO THE NATURE OF THE SFECO TRANSACTION AND THE ADVANTAGES AND DISADVANTAGES, SHAREHOLDERS ARE LIKELY TO BE BETTER OFF IF THE SFECO TRANSACTION PROCEEDS, THAN IF IT DOES NOT.**

### 1.3 Directors' Recommendation

The Directors of Chalice **unanimously recommend** Shareholders approve the Resolution, being the sale of the Company's remaining 60 per cent interest in the Zara Project.

Each Director intends to vote his shares in Chalice over which he has voting power in favour of the Resolution.

At the date of this Notice, the Directors' voting power is as follows:

| Name | Number of Shares | % of Shares |
|---|---|---|
| Tim Goyder | 29,699,342 | 11.88% |
| Douglas Jones | 296,278 | 0.14% |
| Anthony Kiernan | 1,162,041 | 1.60% |
| Stephen Quin | 26,321 | 0.01% |

### 1.4 Overview of the Zara Project

***(a) Location***

The Zara Project, comprises the Koka Gold Deposit the subject of the Mining Licences and the Exploration Licenses covering an area of approximately 530 sq km situated in northern Eritrea, approximately 160 km northwest of the country's capital, Asmara.

In relation to the Zara Project, the focus has been on the Koka Gold Deposit upon which the Feasibility Study was completed and delivered to the Eritrean Government in July 2010.

***(b) Mineral Reserves and Resources***

AMC Consultants Pty Ltd (**AMC**) has completed a Mineral Resource and Ore Reserve estimate for the Koka Gold Deposit in accordance with the JORC Code. The Indicated Resource and Ore Reserve categories referred to in the JORC Code are directly comparable to the Indicated Mineral Resource and Mineral Reserve categories defined in the CIM Definition Standards respectively.

The Mineral Resource estimate using a 1.2 g/t gold cut-off is:

| Category | Tonnes (Mt) | Grade (g/t gold) | Contained Gold |
|---|---|---|---|
| Indicated | 5.0 | 5.3 | 840,000 |

The Ore Reserve estimate is:

| Category | Tonnes (Mt) | Grade (g/t gold) | Contained Gold |
|---|---|---|---|
| Probable Reserve | 4.6 | 5.1 | 760,000 |

NB: The above Mineral Resource and Ore Reserve are on a 100 per cent ownership basis.

***(c) The Zara Project Ownership***

Chalice has a 60 per cent interest in the Zara Project which is represented by its 60 per cent shareholding in the operating company, Zara Mining Share Company ("**ZMSC**"). The remaining 40 per cent shareholding is owned by ENAMCO, of which 30 per cent is a contributing interest and 10 per cent free carried.

Financial contributions to ZMSC are 66.6 per cent by Chalice and 33.3 per cent by ENAMCO.

***(d) Feasibility Study***

The key financial outcomes of the Feasibility Study, which was completed in July 2010 by Lycopodium Minerals Limited with inputs from AMC Consultants Pty Ltd and Knight Piésold Pty Ltd, are shown below. All figures are in US dollars except where noted, and reflect **100 per cent of the Zara Project**.

100% Project Financial Outcomes:

| | Gold Price ($/oz) | | |
|---|---|---|---|
| **(Unleveraged)** | **US$900** | **US$1,200** | **US$1,500** |
| Life-of-mine EBITDA | US$381M | US$589M | US$797M |
| Average annual EBITDA | US$54M | US$84M | US$114M |
| IRR after-tax | 22% | 35% | 45% |
| Payback period (years) | 2.8 | 2.1 | 1.8 |

Feasibility Key Parameters and Outcomes:

| Base Case Assumptions | | |
|---|---|---|
| Gold price base case | US$/oz | 900 |
| Foreign exchange rate | AUD/US$ | 0.85 |
| Foreign exchange rate | Eritrean Nakfa/US$ | 15.00 |
| Fuel price | US$/litre | 1.00 |
| Fiscal Parameters | | |
| Corporate tax rate | % | 38 |
| Royalty | % | 5.0 |
| Base Case Mine Parameters | | |
| Ore milled (Mt) | Mt | 4.6 |

| | | |
|---|---|---|
| Waste mined (Mt) | Mt | 48.3 |
| Strip ratio (ore-waste) | t:t | 10.4 |
| Average gold grade | g/t | 5.10 |
| Total contained gold | Oz | 760,000 |
| Estimated gold recovery | % | 96.3 |
| Total recovered gold | Oz | 730,780 |
| Life of Mine | Years | 7 |
| Average annual gold production | Oz | 104,000 |
| Base Case Cost Parameters | | |
| Pre-production capital | US$M | 122 |
| Sustaining capital and mine closure | US$M | 9 |
| Average total cash costs US$/oz) | US$/oz | 338 |

***(e) Competent Persons and Qualified Person Statement***

The information in this Notice of Meeting that relates to exploration results is based on information compiled by Dr Doug Jones, a full-time employee and Director of Chalice, who is a Member of the Australasian Institute of Mining and Metallurgy and is a Chartered Professional Geologist. Dr Jones has sufficient experience in the field of activity being reported to qualify as a Competent Person as defined in the 2004 edition of the Australasian Code for Reporting of Exploration Results, Minerals Resources and Ore Reserves, and is a Qualified Person under National Instrument 43-101 – 'Standards of Disclosure for Mineral Projects'. The Qualified Person has verified the data disclosed in this release, including sampling, analytical and test data underlying the information contained in this release. Dr Jones consents to the release of information in the form and context in which it appears here.

The Mineral Resource estimate was prepared by Mr. John Tyrrell who is a Member of the Australasian Institute of Mining and Metallurgy. Mr. Tyrrell is a full time employee of AMC Consultants Pty Ltd (**AMC**) and has sufficient experience in gold resource estimation to act as Competent Person as defined in the 2004 Edition of the 'Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves (the JORC Code)' and was a Qualified Person under National Instrument 43-101 – 'Standards of Disclosure for Mineral Projects' at the date the National Instrument 43-101 was filed with the Toronto Stock Exchange. Mr Tyrrell consents to the inclusion of this information in the form and context in which it appears.

The information in this Notice of Meeting of Ore Reserves is based on information compiled by Mr David Lee who is a Member of the Australasian Institute of Mining and Metallurgy and a full time employee of AMC. Mr Lee has sufficient relevant experience to be a Competent Person as defined in the JORC Code and was a Qualified Person under National Instrument 43-101 – 'Standards of Disclosure for Mineral Projects' at the date the National Instrument 43-101 was filed with the Toronto Stock Exchange. Mr Lee consents to the inclusion of this information in the form and context in which it appears.

### 1.5 Reasons for the Directors Unanimously Recommending the Transaction

Shareholders should appreciate Directors gave considerable thought to the offer by SFECO that led to the execution of the SFECO Agreement and took a range of matters into consideration in evaluating the same and the variance between that after and that subject of the Heads of Terms dated 26 December 2011. The principal matters the Directors considered are set out below and after taking all these into consideration the Directors unanimously concluded it would be in the best interests of Chalice Shareholders to accept the SFECO offer and to complete the SFECO Transaction.

***(a) Crystallisation of Value at a Premium to Market***

The SFECO Transaction (the subject of the Resolution) and the separate ENAMCO Transaction imply a premium to Chalice's market prices prior to the first announcement of the proposed transaction to the market, i.e. December 2011.

The after tax transaction value (for the SFECO Transaction and the ENAMCO Transaction) is expected to be approximately A$0.34 per Share.

The implied premium as compared to the 5, 10 and 20 day volume weighted average price (**VWAP**) prior to announcing that a non-binding letter of intent had been signed with a third party to acquire Chalice's interest in the Zara Project on 13 December 2011 is as follows:

| | VWAP | Premium compared to after tax transaction value |
|---|---|---|
| 5 Day VWAP | 26.6 cents | 28% |
| 10 Day VWAP | 25.1 cents | 35% |
| 20 Day VWAP | 26.1 cents | 34% |

The implied premium as compared to the 5, 10 and 20 day volume weighted average price (**VWAP**) prior to announcing the Heads of Terms with SFECO to acquire Chalice's interest in the Zara Project on 28 December 2011 is as follows:

| | VWAP | Premium compared to after tax transaction value |
|---|---|---|
| 5 Day VWAP | 28.2 cents | 20% |
| 10 Day VWAP | 29.6 cents | 15% |
| 20 Day VWAP | 28.8 cents | 18% |

***(b) Dilutionary Impact of Funding the Zara Project***

Based on the Feasibility Study, ZMSC would need to source funding of at least US$122 million for capital expenditure in addition to working capital. Chalice would be required to contribute two thirds of this funding with ENAMCO funding the balance. Whilst debt funding the development of the Koka Gold Mine is a viable option, it is likely that a significant component of the total cost would need to be raised in equity by Chalice.

With a market capitalisation of approximately $67 million on 12 December 2011 (the trading day prior to the initial announcement that a non-binding letter of intent had been signed with a third party to sell the Zara Project) and a share price of $0.27, it is highly likely that any future equity raising would be dilutive to existing shareholders.

***(c) Avoids Risks of Developing the Zara Project***

By approving the SFECO Transaction, Shareholders will avoid exposure to the risks associated with financing, constructing and operating a gold mine. In particular, a single asset company like Chalice may face distinct challenges when developing a mine in a developing country.

Whilst it is possible that retaining Chalice's 60 per cent interest in the Zara Project may deliver equivalent or greater values to Shareholders than that which would be delivered under the SFECO Transaction, this needs to be considered in light of:

(i) mining and financing risks associated with achieving a potentially higher return from the generation of future cash flows of the Zara Project;

(ii) the time required for Chalice to achieve such a return and any associated holding costs; and

(iii) the benefit of monetising the investment now.

**1.6 Chalice Activities post completion of SFECO Transaction**

If the SFECO and ENAMCO Transactions are completed, Chalice will have estimated cash (after tax) in the bank of $84 million or cash backing of approximately $0.34 per Share.

Upon completion of the SFECO and ENAMCO Transactions, the Chalice Board will look for further investment opportunities for the Company in the resources sector. No defined parameters have been determined at this stage, although it is more than likely that Chalice will be looking for an investment in a developed or developing project as opposed to grassroots or seed capital positions.

In the short term and subject to receiving positive exploration results, Chalice will maintain an exploration presence in Eritrea by continuing exploration at its Mogoraib North and Hurum Projects (owned 60 per cent by Chalice and 40 per cent by ENAMCO). The Mogoraib North Project lies about 100km south of the Zara Project and immediately north of TSX listed Nevsun Resources' Bisha mine.

A VTEM, magnetic and radiometric survey completed last year over Mogoraib North identified a series of conductive bodies with the potential to host mineralisation similar in style to the Bisha polymetallic VHMS mine.

**1.7 Tax Treatment for the SFECO Transaction**

As discussed in section 1.1(c) above, Chalice will be liable to pay tax to the Eritrean Government on the SFECO and ENAMCO Transactions proceeds at the rate of 38 per cent. The Directors anticipate this tax to be approximately US$26 million (~A$25 million).

Chalice has obtained Australian tax advice in relation to the SFECO Transaction. The sale will result in a capital gain and will be fully taxable in Australia. However, as the SFECO Transaction is taxable in Eritrea at a rate of 38 per cent, Chalice Group will be entitled to a foreign tax credit to reduce the Australian tax liability to nil.

## 1.8 Pro forma Balance Sheets

Pro forma balance sheets are set out below to demonstrate the financial position of the Company following completion of:

(i) the SFECO Transaction;
(ii) the ENAMCO Transaction; and
(iii) payment of approximately US$26 million in Eritrean profits tax.

The unaudited balance sheet at 31 March 2012 of the consolidated Chalice Group is used for this purpose. Within the knowledge of the Directors, there has been no material change in the financial position of the Company since these financial statements to the date of this Notice, except as otherwise disclosed elsewhere in this Notice.

| | Consolidated 31 March 2012[1.] | ZMSC De-consolidation | ENAMCO Transaction | SFECO Transaction | Eritrean Tax Payment | Dragon Deferred Payment Settlement | Pro forma Consolidated 31 March 2012 |
|---|---|---|---|---|---|---|---|
| | A$ | A$ | A$ | A$ | A$ | A$ | A$ |
| **Current assets** | | | | | | | |
| Cash and cash equivalents | 4,750,000 | (1,137,000) | 30,665,000[6.] | 75,968,000 | (24,835,000)[4.] | (1,500,000)[5.] | 83,911,000 |
| Trade and other receivables | 1,941,000 | (1,718,000) | - | - | - | - | 223,000 |
| **Total current assets** | **6,691,000** | **(2,855,000)** | **30,665,000** | **75,968,000** | **(24,835,000)** | **(1,500,000)** | **84,134,000** |
| **Non-current assets** | | | | | | | |
| Financial assets | 870,000 | - | - | - | - | - | 870,000 |
| Exploration and evaluation assets | 15,487,000 | (12,800,000) | - | - | - | - | 2,687,000 |
| Property, plant and equipment | 31,961,000 | (31,655,000) | - | - | - | - | 306,000 |
| **Total non-current assets** | **48,318,000** | **(44,455,000)** | **-** | **-** | **-** | **-** | **3,863,000** |
| **Total assets** | **55,009,000** | **(47,310,000)** | **30,665,000** | **75,968,000** | **(24,835,000)** | **(1,500,000)** | **87,997,000** |
| **Current liabilities** | | | | | | | |
| Trade and other payables | (1,536,000) | 1,403,000 | - | - | - | - | (133,000) |
| Employee benefits | (81,000) | - | - | - | - | - | (81,000) |
| Unearned income | (2,895,000) | - | 2,895,000[3.] | - | - | - | - |
| **Total current liabilities** | **(4,512,000)** | **1,403,000** | **2,895,000** | **-** | **-** | **-** | **(214,000)** |
| **Non-current Liabilities** | | | | | | | |
| Loans and borrowings | (3,852,000) | 3,852,000 | - | - | - | - | - |
| Provisions | (48,000) | - | - | - | - | - | (48,000) |
| **Total non-current liabilities** | **(3,900,000)** | **3,852,000** | **-** | **-** | **-** | **-** | **(48,000)** |
| **Total liabilities** | **(8,412,000)** | **5,255,000** | **2,895,000** | **-** | **-** | **-** | **(262,000)** |
| **Net assets** | **46,597,000** | **(42,055,000)** | **33,560,000** | **75,968,000** | **(24,835,000)** | **(1,500,000)** | **87,735,000** |

Notes to the pro-forma balance sheet at 31 March 2012:

1. The balance sheet at 31 March 2012 is unaudited;
2. The exchange rate applied to US dollar transactions including the SFECO Transaction, the ENAMCO Transaction and the associated tax payable is the closing rate at 31 March 2012 of **US$1 : A$0.9652**;
3. Relates to advance payment from ENAMCO of US$3 million as outlined in 1.1 (a) above;
4. Tax payable is an estimate only and is subject to assessment by the Inland Revenue Department in Eritrea;
5. On 27 April 2012, Chalice and Dragon Mining Limited agreed to set aside the trailing payment of A$4 million to Dragon in the event that a one million ounce Ore Reserve is delineated at the Zara Project in consideration for an up-front one-off payment of $1.5 million; and
6. ENAMCO proceeds include accrued interest at a rate of 5 % per annum.

## FORWARD LOOKING STATEMENT

This Notice of Meeting may contain forward-looking information within the meaning of Canadian securities legislation and forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995 (collectively, “forward-looking statements”). These forward-looking statements are made as of the date of this document and Chalice does not intend, and does not assume any obligation to update these forward-looking statements except as required by law or regulation.

This document may contain forward-looking information within the meaning of Canadian securities legislation and forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995 (collectively, “forward-looking statements”). These forward-looking statements are made as of the date of this document and Chalice does not intend, and does not assume any obligation, to update these forward-looking statements, except as required by law or regulation.

Forward-looking statements relate to future events or future performance and reflect Company management’s expectations or beliefs regarding future events and include, but are not limited to, statements with respect to the estimation of mineral reserves and mineral resources, the realisation of mineral reserve estimates, the likelihood of exploration success, the timing and amount of estimated future production, costs of production, capital expenditures, success of mining operations, environmental risks, unanticipated reclamation expenses, title disputes or claims and limitations on insurance coverage, as well as the possibility that a sale of the Zara Gold Project may be consummated due to conditions precedent to completion of the Sale and Purchase Agreement outlined in this Notice of Meeting.

In certain cases, forward-looking statements can be identified by the use of words such as plans, expects or does not expect, is expected, budget, scheduled, estimates, forecasts, intends, anticipates or does not anticipate, or believes, or variations of such words and phrases or statements that certain actions, events or results may, could, would, might or will be taken, occur or be achieved or the negative of these terms or comparable terminology. By their very nature forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Such factors include, among others, risks related to actual results of current exploration activities; changes in project parameters as plans continue to be refined; future prices of mineral resources; possible variations in ore reserves, grade or recovery rates; accidents, labour disputes and other risks of the mining industry; delays in obtaining governmental approvals or financing or in the completion of development or construction activities; due to conditions precedent to the completion of the Sale and Purchase Agreement, completion of the sale of the Zara Gold Project to SFECO; the tax payable on any such transaction; completion of the sale of a 30 per cent interest in the Zara Gold Project to the Eritrean National Mining Corporation; the use of any sale proceeds received from the sale of the Zara Gold Project; as well as those factors detailed from time to time in the Company’s interim and annual financial statements, all of which are filed and available for review on SEDAR at sedar.com. Although the Company has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors that cause actions, events or results not to be as anticipated, estimated or intended. There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements.

Accordingly, readers should not place undue reliance on forward-looking statements.

### Cautionary Note

For readers to fully understand the information in this Notice of Meeting, they should read the Technical Report for the Koka Gold Deposit dated July 27, 2010 (available at www.chalicegold.com) in its entirety, including all qualifications, assumptions and exclusions that relate to the information set out in this Notice of Meeting which qualifies the Technical Information. Readers are advised that mineral resources that are not mineral reserves do not have demonstrated economic viability. The Technical Report is intended to be read as a whole, and sections should not be read or relied upon out of context. The technical information in the report is subject to the assumptions and qualifications contained in the Technical Report.

**GLOSSARY**

The following is a glossary of terms and abbreviations used frequently throughout this Explanatory Statement and in the Notice of Meeting and which such meanings shall apply unless the context requires otherwise. Additional terms used only occasionally are defined where used in their first instance in the body of this Explanatory Statement.

"**ASIC**" means the Australian Securities and Investments Commission.

"**ASX**" means ASX Limited or the Australian Securities Exchange, as appropriate.

"**ASX Listing Rules**" means the Listing Rules of ASX.

"**Board of Directors**" or "**Board**" means the board of Directors.

"**Business Day**" means a day, other than Saturdays, Sundays or any other public holiday in Perth, Western Australia.

"**Chalice**" or "**Company**" means Chalice Gold Mines Limited (ABN 47 116 648 956).

**"Chalice Shareholder Loans"** means loans of US$7,410,647 made by Chalice or a member of the Chalice group to ZMSC as at 30 November 2011.

"**CIM Standards**" means the standards on mineral resources and mineral reserves developed by the CIM Standing Committee establishing definitions and guidelines for the reporting of exploration information, mineral resources and mineral reserves in Canada.

"**Corporations Act**" means the Corporations Act 2001 (Cwlth).

**"Director"** means a director of the Company.

"**ENAMCO**" means Eritrean National Mining Corporation, which is the entity through which the State of Eritrea holds various mining interests.

"**ENAMCO Transaction**" has the meaning given to it in the fourth paragraph of section 1.1 of the Explanatory Memorandum.

**"Exploration Licences"** means the six contiguous exploration licenses (Zara Central comprising Zara 1, 2, 3 and 4, Zara North and Zara South) granted on 25 November 2010.

"**Feasibility Study**" means the feasibility study undertaken on the Koka Gold Deposit (which forms part of the Zara Project) by Lycopodium Minerals Pty Ltd and which was completed and delivered to the Eritrean Government in July 2010.

"**Heads of Terms**" has the meaning given to it in the second paragraph of section 1.1(a) of the Explanatory Statement.

"**JORC Code**" means Australasian Code for Reporting Exploration Results, Mineral Resources and Ore Reserves prepared by the Joint Ore Reserves Committee of the Australasian Institute of Mining and Metallurgy, Australian Institute of Geoscientists and Minerals Council of Australia.

"**Koka Gold Deposit**" means the mineral resource of 840,000 oz of gold within the Zara Project described in the Feasibility Study, and the "**Koka Gold Mine**" is a reference to the mine that may be developed as contemplated by the Feasibility Study.

**"Mining Licences" means m**ining licences No.01/2012 and No.02/2012 granted to ZMSC on 11 January 2012.

**"Notice**" or **"Notice of Meeting"** means this notice of meeting including the Explanatory Statement.

"**SFECO Transaction**" has the meaning given to it in the first paragraph at section 1.1 of the Explanatory Statement.

**"TSX"** means the Toronto Stock Exchange.

"**Zara Project**" means the Project which comprises the Mining Licences in respect of the Koka Gold Deposit and the Exploration Licences as referred to in section 1.4(a) of the Explanatory Statement.

"**ZMSC**" means Zara Mining Share Company, an entity incorporated under the laws of the State of Eritrea, which is the owner, operator and holding company of the Zara Project, shareholders of which are Chalice Gold Mines (Eritrea) Pty Ltd and ENAMCO.

**CHALICE GOLD MINES LIMITED**
**ABN 47 116 648 956**

**PROXY FORM**

**APPOINTMENT OF PROXY**

I/We

being a Shareholder of Chalice Gold Mines Limited entitled to attend and vote at the General Meeting, hereby

appoint

Name of proxy

or failing the person so named or, if no person is named, the Chairman of the General Meeting, as my/our proxy to act generally at the General Meeting on my/our behalf and to vote in accordance with the following directions or, if no directions have been given, as the proxy sees fit, at the General Meeting of Chalice Gold Mines Limited to be held at 10am (WST) on 29 June 2012 at Middletons, Level 32, 44 St Georges Terrace, Perth, Western Australia and at any adjournment of that meeting.

**Voting on Business of the General Meeting**

| | | FOR | AGAINST | ABSTAIN |
|---|---|---|---|---|
| Resolution 1 | Disposal of Chalice's 60 Per cent Interest in the Zara Project | ☐ | ☐ | ☐ |

If you mark the abstain box for a particular item, you are directing your proxy not to vote on that item on a show of hands or on a poll and that your shares are not to be counted in computing the required majority on a poll.

☐ **IMPORTANT** If the Chairman of the Meeting is your nominated proxy, or may be appointed by default, and you have not directed your proxy how to vote, please place a mark in this box with an 'X'. By marking this box you acknowledge that the Chairman of the Meeting may exercise your proxy even if he has an interest in the outcome of the resolutions (or that they are connected directly or indirectly with the remuneration of a member of key management personnel) and that votes cast by him, other than as a proxy holder, would be disregarded because of that interest. If you do not mark this box, and you have not directed your proxy how to vote, the Chairman of the Meeting will not cast your votes on the resolutions and your votes will not be counted in computing the required majority if a poll is called. The Chairman of the Meeting intends to vote undirected proxies in favour of each resolution.

Signed this day of 2012

**By:**

| **Individuals and joint holders** | **Companies (affix common seal if appropriate)** |
|---|---|
| Signature | Director |
| Signature | Director/Company Secretary |
| Signature | Sole Director and Sole Company Secretary |

**CHALICE GOLD MINES LIMITED**

**ABN 47 116 648 956**

**Instructions for Completing 'Appointment of Proxy' Form**

1. A Shareholder entitled to attend and vote at a meeting is entitled to appoint not more than two proxies to attend and vote on their behalf. Where more than one proxy is appointed, such proxy must be allocated a proportion of the Shareholder's voting rights. If the Shareholder appoints two proxies and the appointment does not specify this proportion, each proxy may exercise half the votes.

2. A duly appointed proxy need not be a Shareholder of the Company.

3. **Signing Instructions**

   You must sign this form as follows in the spaces provided:

   Individual: where the holding is in one name, the holder must sign.

   Joint Holding: where the holding is in more than one name, all of the Shareholders should sign.

   Power of Attorney: to sign under Power of Attorney, you must have already lodged this document with the Company's share registry. If you have not previously lodged this document for notation, please attach a certified photocopy of the Power of Attorney to this form when you return it.

   Companies: where the company has a Sole Director who is also the Sole Company Secretary, this form must be signed by that person. If the company (pursuant to section 204A of the Corporations Act 2001) does not have a Company Secretary, a Sole Director can also sign alone. Otherwise this form must be signed by a Director jointly with either another Director or a Company Secretary. Please indicate the office held by signing in the appropriate place.

   If a representative of the corporation is to attend the meeting a "Certificate of Appointment of Corporate Representative" should be produced prior to admission. A form of the certificate is included with the Notice of General Meeting.

4. Completion of a proxy form will not prevent individual Shareholders from attending the meeting in person if they wish. Where a Shareholder completes and lodges a valid proxy form and attends the meeting in person, then the proxy's authority to speak and vote for that Shareholder is suspended while the Shareholder is present at the meeting.

5. To vote by proxy, please complete and sign the proxy form enclosed and either send the proxy form:

   (a) by post to Chalice Gold Mines Limited, GPO Box 2890, Perth, WA, 6001; or

   (b) by facsimile to the Company on facsimile number +61 8 9322 5800,

   so that it is received no later than **10 am (WST) on 28 June 2012,** being not less than 48 hours before the time of the meeting. Proxy forms received later than this time will be invalid.

**Appointment of Corporate Representative**

**Section 250D of the Corporations Act 2001 (Cwlth)**

This is to certify that by a resolution of the directors of:

……………………………………………………………………………………………. *(Insert name of company)*

(**Company**), the Company has appointed:

……………………………………………………………………………………………, *(Insert name of corporate representative),*

in accordance with the provisions of section 250D of the Corporations Act 2001 (Cwlth), to act as the body corporate representative of that company at the General Meeting of Chalice Gold Mines Limited to be held at 10am (WST) on 29 June 2012 and at any adjournment of that meeting.

**DATED** 2012

**Executed by** the Company )
)
in accordance with its constituent documents

| | |
|---|---|
| ……………………………………………… | ……………………………………………… |
| Signed by authorised representative | Signed by authorised representative |
| ……………………………………………… | ……………………………………………… |
| Name of authorised representative (print) | Name of authorised representative (print) |
| ………………………………………… | ………………………………………… |
| Position of authorised representative (print) | Position of authorised representative (print) |

**INSTRUCTIONS FOR COMPLETION**

Under Australian law, an appointment of a body corporate representative will only be valid if the Certificate of Appointment is completed precisely and accurately.

Please follow the following instructions to complete the Certificate of Appointment:

1. Execute the certificate following the procedure required by your company's constitution or other constituent documents.
2. Print the name and position (eg director) of each company officer who signs this certificate on behalf of the company.
3. Insert the date of execution where indicated.
4. Send or deliver the certificate to the registered office of Chalice Gold Mines Limited or fax the certificate to the registered office at (+61 8) 9322 5800.

# Independent Expert's Report and Financial Services Guide

## Chalice Gold Mines Limited

## Sale of the Remaining 60% Interest in the Zara Gold Project

16 May 2012

Ernst & Young

**Ernst & Young Transaction Advisory Services Limited**
Ernst & Young Building
11 Mounts Bay Road
Perth WA 6000 Australia
GPO Box M939 Perth WA 6843

Tel: +61 8 9429 2222
Fax: +61 8 9429 2192
www.ey.com/au

# PART 1 – INDEPENDENT EXPERT'S REPORT

The Directors
Chalice Gold Mines Limited
Level 2, 1292 Hay Street
West Perth WA 6005

16 May 2012

Dear Sirs

## Sale of the Remaining 60% Interest in the Zara Gold Project

On 28 December 2011, Chalice Gold Mines Limited ("Chalice" or the "Company") announced that it had entered into a conditional agreement (the "Heads of Terms") with China SFECO Group ("SFECO") for the sale of the Company's remaining 60% interest in Zara Mining Share Company ("ZMSC"), the holder of the Zara Gold Project (the "Zara Project") and Chalice's shareholder loan to ZMSC (the "Chalice Shareholder Loan") (the "Proposed Transaction"). The Zara Project is located in the African country of Eritrea and incorporates the undeveloped Koka Gold Mine.

The announcement of the Proposed Transaction followed the agreement reached in July 2011 under which Chalice agreed to sell a 30% interest in ZMSC to the Eritrean National Mining Corporation ("ENAMCO"). This was in addition to the 10% free carried interest already held by ENAMCO.

Following the completion of SFECO's due diligence review of ZMSC, on 18 April 2012 Chalice announced that as a result of further negotiations between itself and SFECO, the cash consideration payable for the Proposed Transaction would be US$80 million, comprising an amount of US$78 million on settlement and US$2 million on the first gold pour from the Koka Gold Mine. A sale and purchase agreement (the "SPA") was executed between SFECO, Shanghai Construction (Hong Kong) Limited and Chalice on 27 April 2012.

SFECO and Shanghai Construction (Hong Kong) Limited are wholly owned subsidiaries of Shanghai Construction Group Co. Ltd, a Chinese State controlled company (these three entities are collectively included in our reference to SFECO).

The sale of the 30% interest in ZMSC with ENAMCO is to be completed simultaneously with the Proposed Transaction.

Chalice shareholders are to consider a resolution seeking approval of the Proposed Transaction at a general meeting of the Company that is to be held on or about 29 June 2012 (the "Meeting"). In the absence of a superior proposal, the Directors of Chalice have unanimously recommended that shareholders of Chalice ("Chalice Shareholders") vote in favour of the Proposed Transaction.

While the Proposed Transaction requires shareholder approval, the provision of an independent expert's report is not specifically required under the Corporations Act or the Australian Securities Exchange ("ASX") Listing Rules. However, for reasons of good corporate governance, the Directors of Chalice have moved to have an independent expert's report prepared in respect to the Proposed Transaction as part of the information to be provided to Chalice Shareholders to assist them to consider the merits or otherwise of the Proposed Transaction.

In this regard Ernst & Young Transaction Advisory Services Limited ("Ernst & Young Transaction Advisory Services") has been appointed by the Directors to prepare the independent expert's report, the purpose of which is to state whether or not, in our opinion, the Proposed Transaction is fair and reasonable to Chalice Shareholders. Our report is being included in the Notice of Meeting and Explanatory Statement being sent to Chalice Shareholders in respect to the Meeting.

Neither the Corporations Act nor the ASX Listing Rules define the term 'fair and reasonable' and provide no direct guidance on what should be considered when assessing whether or not a particular transaction is fair and reasonable. In this context, the Australian Securities and Investment Commission has issued Regulatory Guide 111: *Content of expert reports* ("RG 111") which provides some direction as to what matters an independent expert should consider and how 'fair and reasonable' should be interpreted in a range of circumstances.

Under RG 111 a key matter the expert needs to consider is that the form of the analysis used in evaluating a transaction should address the issues faced by the security holders. In this regard the disposal of the 60% interest in the Zara Project under the Proposed Transaction represents the sale of Chalice's major mineral asset and undertaking. From a Chalice shareholder perspective it is important that the Company is adequately compensated.

Accordingly, in assessing whether or not the Proposed Transaction to Chalice Shareholders is 'fair and reasonable' a major part of our assessment has been the comparison of the value of the 60% interest in ZMSC, which holds the Zara Project, together with the Chalice Shareholder Loan, with the value of the of the consideration being offered by SFECO. Under this analysis, the Proposed Transaction would be considered 'fair' if the consideration being offered by SFECO is equal to or greater than the value of the 60% interest in ZMSC together with the value of the Chalice Shareholder Loan. If 'fair' we would also consider the Proposed Transaction to be 'reasonable'. If 'not fair' we may consider the Proposed Transaction to still be 'reasonable' if the advantages of accepting the Proposed Transaction outweigh the disadvantages. The form of this analysis is consistent with RG 111.

### *Summary of Opinion*

In Section 8.2 we set out our valuation conclusions, which show the cash consideration being offered by SFECO under the Proposed Transaction is at a premium of 3.1% at the low end and a discount of 13.8% at the high end to our assessed value of the 60% interest in ZMSC, including the Zara Project, together with the Chalice Shareholder Loan. Accordingly, of our assessed valuation range approximately 82% is at a discount to our assessed values of the asset being disposed of by Chalice under the Proposed Transaction.

In Section 8.3, we set out the commercial and qualitative factors relevant to the consideration of the Proposed Transaction and in Section 8.4 we considered other factors relevant to the Proposed Transaction. While individual shareholders may interpret these factors differently depending on their own individual circumstances, in Ernst & Young Transaction Advisory Services' opinion the potential advantages outweigh the potential disadvantages to the shareholders as a whole.

Based on the results of the analysis undertaken and taking into consideration the matters detailed in our report, in the opinion of Ernst & Young Transaction Advisory Services the Proposed Transaction is not fair but reasonable to Chalice Shareholders.

Having regard to the nature of the Proposed Transaction and the advantages and disadvantages, it is the opinion of Ernst & Young Transaction Advisory Services, that Chalice Shareholders are likely to be better off if the Proposed Transaction proceeds.

## *Other Matters*

This independent expert's report has been prepared specifically for Chalice Shareholders. Neither Ernst & Young Transaction Advisory Services, Ernst & Young nor any employee thereof undertakes responsibility to any person, other than Chalice Shareholders, in respect of this report, including any errors or omissions howsoever caused.

This independent expert's report constitutes general financial product advice only and has been prepared without taking into consideration the individual circumstances of Chalice Shareholders. The decision as to whether to approve or not approve the Proposed Transaction is a matter for individual Chalice Shareholders. Chalice Shareholders should have regard to the Notice of Meeting and Explanatory Statement prepared by the Directors and management of the Company in relation to the Proposed Transaction. Chalice Shareholders who are in doubt as to the action they should take in relation to the Proposed Transaction should consult their own professional adviser.

Our opinion is made as at the date of this letter and reflects circumstances and conditions as at that date. This letter must be read in conjunction with the full independent expert's report as attached.

Ernst & Young Transaction Advisory Services has prepared a Financial Services Guide in accordance with the Act. The Financial Services Guide is included as Part 2 of this report.

Yours faithfully
Ernst & Young Transaction Advisory Services Limited

Ken Pendergast
Director and Representative

Brenda Moore
Representative

## Contents

# 1. Details of the Proposed Transaction

## 1.1 Overview

On 28 December 2011, Chalice announced that, through its wholly owned subsidiary Chalice Gold Mines (Eritrea) Pty Ltd ("CGM(E)"), it had entered into a Heads of Terms under which it conditionally agreed to sell its 60% interest in ZMSC to SFECO. ZMSC is the holder of various exploration and mining licences in Eritrea which comprise the Zara Project, incorporating the undeveloped Koka Gold Mine. The Heads of Terms was subject to the satisfactory completion of due diligence on ZMSC by SFECO[1].

Following the completion of SFECO's due diligence review of ZMSC, on 18 April 2012 Chalice announced that as a result of further negotiations between itself and SFECO, the cash consideration payable for the 60% interest in ZMSC and the Chalice Shareholder Loan would be US$80 million (the "Cash Consideration"), comprising an amount of US$78 million on settlement and US$2 million on the first gold pour from the Koka Gold Mine. The SPA was executed between SFECO, Shanghai Construction (Hong Kong) Limited and Chalice on 27 April 2012.

SFECO and Shanghai Construction (Hong Kong) Limited are wholly owned subsidiaries of Shanghai Construction Group Co. Ltd, a Chinese State controlled company (these three entities are collectively included in our reference to SFECO).

In addition to the Cash Consideration, SFECO has agreed to reimburse Chalice for the expenditure funded by the Company in relation to the Zara Project for the period 1 December 2011 until settlement. This is estimated to be approximately US$700,000.

Separate from the Proposed Transaction, in July 2011 Chalice announced that it had entered into an agreement to sell a 30% interest in ZMSC to ENAMCO for US$32 million plus approximately US$2 million reimbursement of costs (the "ENAMCO Transaction"). To date Chalice has received approximately US$3 million of the amount owing from ENAMCO. The acquisition of the 30% interest is in addition to the 10% free carried interest that ENAMCO already held. The 60% interest being sold to SFECO under the Proposed Transaction is post the sale of the additional 30% to ENAMCO. The transaction with ENAMCO is to be completed simultaneously with the Proposed Transaction.

If the Proposed Transaction is implemented, Chalice will receive Cash Consideration of up to US$80 million, with ZMSC and the Zara Project being owned 60% by SFECO and 40% by ENAMCO. Chalice will continue to maintain a presence in Eritrea through the Mogoraib North and Hurum projects, which are early stage gold and base metal exploration projects. Mogoraib North is located approximately 10km north of the Bisha Gold and Base Metal Mine, which is 60% owned and operated by Nevsun Resources Ltd ("Nevsun"), a Canadian company listed on the Toronto Stock Exchange ("TSX"). Hurum is located adjacent to the Zara South license area, which is part of the Zara Project.

Chalice Shareholders are to consider a resolution seeking approval of the Proposed Transaction at the Meeting. In the absence of a superior proposal, the Directors of Chalice have unanimously recommended that Chalice Shareholders vote in favour of the Proposed Transaction.

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[1] Under the Heads of Terms Agreement, the consideration to be paid was comprised of US$80 million for the indirect interest in the Koka Gold Mine and the loans owing by ZMSC to Chalice (or any group company) and the lower of such price to be agreed by Chalice and SFECO or the assessed value up to a maximum of US$20 million for the area covered by the Zara Project outside of the Koka Gold Mine.

## 1.2 Conditions precedent

The implementation of the Proposed Transaction is subject to a number of conditions (some of which may be waived by agreement between Chalice and SFECO) including, amongst other matters:

- All necessary approvals received from governments and other regulatory bodies;
- Approval from Chalice Shareholders;
- SFECO providing satisfactory evidence to ENAMCO that it has the necessary technical and financial resources to meet the obligations of Chalice under the shareholders agreement in respect of ZMSC as between Chalice and ENAMCO and is of good standing and reputation, and SFECO entering into an agreement with ENAMCO on the same terms as that shareholders agreement or such other legal document satisfactory to ENAMCO;
- SFECO demonstrating to the satisfaction of the Minister of Energy and Mines of the Government of Eritrea that it has access to the requisite financial and technical resources and expertise to carry out the operations under the mining agreement and exploration agreements for the Zara Project and obtaining of the approval of the Minister under such agreements;
- Completion of the transaction between ENAMCO and Chalice for its 30% interest in ZMSC;
- Chalice transfers all exploration licences and other rights or assets that relate to the Zara Project to ZMSC;
- ZMSC not having any loans or other liabilities to Chalice other than the Chalice Shareholder Loan and in relation to the operating expenses referred to above which are to be reimbursed on completion;
- ZMSC having successfully obtained a business licence and tax registration in Eritrea;
- The Exploration Licences for Zara Central (comprising Zara 1,2,3, and 4) having been renewed and certain environmental plans being approved by Eritrean authorities;
- The environmental management plan and social environmental impact assessment having received all necessary approvals from the authorities in Eritrea on a basis acceptable to SFECO; and
- There being no event of force majeure affecting the Zara Project.

Chalice Management has notified us that some of the conditions above have been satisfied or are expected to be satisfied in the near term.

Under the Heads of Terms, in certain circumstances, Chalice will be required to pay to SFECO a break fee in the amount of 1% of the Cash Consideration (the "Break Fee").

Details of the conditions precedent to the Proposed Transaction and the Chalice and SFECO Break Fee are included in the Notice of Meeting and Explanatory Statement.

# 2. Scope of the report

## 2.1 Purpose of the report

While the Proposed Transaction requires shareholder approval, the provision of an independent expert's report is not specifically required under the Corporations Act or the ASX Listing Rules. However, for reasons of good corporate governance and to provide Chalice shareholders with sufficient information to assist them to consider the merits or otherwise of the Proposed Transaction, the Directors of Chalice have engaged Ernst & Young Transaction Advisory Services to prepare an independent expert's report, the purpose of which is to state, in our opinion, whether or not the Proposed Transaction it is fair and reasonable to the Chalice Shareholders.

Our report is being included in the Notice of Meeting being sent to Chalice Shareholders in respect to the Meeting.

## 2.2 Basis of assessment

Neither the Corporations Act nor the ASX Listing Rules define the term 'fair and reasonable' and provide no direct guidance on what should be considered when assessing whether or not a particular transaction is fair and reasonable. In this context, the Australian Securities and Investment Commission has issued Regulatory Guide 111: *Content of expert reports* ("RG 111") which provides some direction as to what matters an independent expert should consider and how 'fair and reasonable' should be interpreted in a range of circumstances.

Under RG 111 a key matter the expert needs to consider is that the form of the analysis used in evaluating a transaction should address the issues faced by the security holders. In this regard the disposal of the 60% interest in the Zara Project under the Proposed Transaction represents the sale of Chalice's major mineral asset and undertaking. From a Chalice shareholder perspective it is important that the Company is adequately compensated.

Accordingly, in assessing whether or not the Proposed Transaction to Chalice Shareholders is 'fair and reasonable' a major part of our assessment has been the comparison of the value of the consideration being offered by SFECO with the value of the 60% interest in ZMSC, which includes the Zara Project together with the Chalice Shareholder Loan. Under this analysis, the Proposed Transaction would be considered 'fair' if the consideration being offered by SFECO is equal to or greater than the value of the 60% interest in ZMSC being sold. If 'fair' we would also consider the Proposed Transaction to be 'reasonable'. If 'not fair' we may consider the Proposed Transaction to still be 'reasonable' if the advantages of accepting the Proposed Transaction outweigh the disadvantages. The form of this analysis is consistent with RG 111.

Consistent with this guidance, in assessing whether or not the Proposed Transaction is 'fair' to Chalice Shareholders we have compared the fair value of the shares in ZMSC being acquired together with Chalice Shareholder Loan being assigned, with the fair value of the Cash Consideration being offered by SFECO.

'Fair value' in this context is considered to be 'the amount at which an asset could be exchanged between a knowledgeable and willing but not anxious seller and a knowledgeable and willing but not anxious buyer both acting at arm's length'.

In considering the fair value of the Zara Project, we appointed mineral specialist firm, CSA Global Pty Ltd ("CSA"), to undertake a technical assessment of the Koka Gold Mine and to assess the value of any exploration potential not captured in the valuation of the Koka Gold Mine. A copy of CSA's report (the "CSA Report") is attached in full at Appendix F and should be read in conjunction with our report.

In placing reliance on the report prepared by CSA we have satisfied ourselves as to its competence and expertise. We are satisfied that the assumptions, methodologies and source data used by CSA are reasonable and appropriate and that the report contains sufficient information to support the conclusions drawn. We are also satisfied that CSA is independent.

The management accounts adopted in our assessment of ZMSC were as at 31 March 2012. In using these accounts in our analysis, management of Chalice has confirmed that there has been no material change to ZMSC's financial position between 31 March 2012 and the date of this report.

Other factors considered in our assessment of the advantages and disadvantages of the Proposed Transaction include the following matters:

- the overall terms of the Proposed Transaction;
- consideration of the trading history of Chalice's shares on the ASX and the TSX in comparison to the amount being paid under the Proposed Transaction;
- the premium, if any, that SFECO may be paying;
- the alternatives to the Proposed Transaction and the consequences for Chalice Shareholders;
- the likely tax impact of the Proposed Transaction;
- the impact of the Proposed Transaction on Chalice's continuing operations;
- the impact of the Proposed Transaction on Chalice's financial position;
- consideration that the Zara Project, being the Company's major asset, is located in Eritrea; and
- other significant matters.

Our assessment of the Proposed Transaction is based on the economic, political, social, market and other conditions prevailing at the date of this report.

Our fair value assessment of ZMSC and Chalice's interest in ZMSC is detailed in Section 7.

All amounts in this report are expressed in Australian dollars ($) unless otherwise stated.

In undertaking our analysis and preparing this report, we have had access to management information in relation to ZMSC and the Company. A list of the sources of information used and relied on is contained in Appendix D.

A glossary detailing the abbreviations we have used in this report is contained in Appendix E.

## 2.3 Shareholders' decisions

This independent expert's report has been prepared specifically for Chalice Shareholders at the request of the Directors of the Company with respect to the Proposed Transaction. As such, Ernst & Young Transaction Advisory Services, Ernst & Young and any member or employee thereof, take no responsibility to any entity other than Chalice Shareholders, in respect of this report, including any errors or omissions howsoever caused.

This report constitutes general financial product advice only and has been prepared without taking into consideration the individual circumstances of Chalice Shareholders. The decision to approve or not approve the Proposed Transaction is a matter for individual shareholders. Chalice Shareholders should consider the advice in the context of their own circumstances, preferences and risk profiles. Chalice Shareholders should have regard to the Notice of Meeting prepared by the Directors and management of the Company. Chalice Shareholders who are in doubt as to the action they should take in relation to the Proposed Transaction should consult their own professional adviser.

Ernst & Young Transaction Advisory Services has prepared a Financial Services Guide in accordance with the Act. The Financial Services Guide is included as Part 2 of this report.

## 2.4 Limitations and reliance on information

In the preparation of this independent expert's report, Ernst & Young Transaction Advisory Services was provided with information in respect of Chalice and obtained additional information from public sources, as set out in Appendix D.

We have had discussions with the management of Chalice in relation to the Proposed Transaction, operations, financial position, operating results and outlook of Chalice.

Ernst & Young Transaction Advisory Services' opinion is based on economic, market and other external conditions prevailing at the date of this report. These conditions can change significantly over relatively short periods of time.

This independent expert's report is also based upon financial and other information provided by Chalice in relation to the Proposed Transaction. Ernst & Young Transaction Advisory Services has considered and relied upon this information.

The information provided to Ernst & Young Transaction Advisory Services has been evaluated through analysis, enquiry and review for the purposes of forming an opinion as to whether the Proposed Transaction is fair and reasonable to Chalice Shareholders. However, Ernst & Young Transaction Advisory Services does not warrant that its enquiries have identified all of the matters that an audit, an extensive examination or 'due diligence' and/or tax investigation might disclose.

Preparation of this report does not imply that we have, in any way, audited the accounts or records of Chalice. It is understood that the accounting information that was provided was prepared in accordance with generally accepted accounting principles for the purposes of Eritrean reporting requirements.

In forming our opinion we have also assumed that:

- matters such as title, compliance with laws and regulations and contracts in place are in good standing and will remain so and that there are no material legal proceedings, other than as publicly disclosed;
- the information set out in the Notice of Meeting to be sent by Chalice to Chalice Shareholders is complete, accurate and fairly presented in all material respects; and
- the publicly available information relied upon by Ernst & Young Transaction Advisory Services in its analysis was accurate and not misleading.

To the extent that there are legal issues relating to assets, properties, or business interests or issues relating to compliance with applicable laws, regulations and policies, we assume no responsibility and offer no legal opinion or interpretation on any issue.

The statements and opinions given in this independent expert's report are given in good faith and in the belief that such statements and opinions are not false or misleading.

Ernst & Young Transaction Advisory Services provided draft copies of this report to the Directors and management of Chalice for their comments as to factual accuracy, as opposed to opinions, which are the responsibility of Ernst & Young Transaction Advisory Services alone. Amendments made to this report as a result of this review have not changed the methodology or conclusions reached by Ernst & Young Transaction Advisory Services.

This report should be read in the context of the full qualifications, limitations and consents set out in Appendix A of this independent expert's report.

This report has been prepared in accordance with APES 225: *Valuation Services* issued by the Accounting Professional & Ethical Standards Board Limited in July 2008.

# 3. Overview of Chalice and ZMSC

## 3.1 Background

Chalice is a gold exploration and development company based in Perth, Western Australia. The Company was incorporated by Bullion Minerals Limited, an ASX listed company, in October 2005 for the purpose of developing an independently focused and funded gold exploration company. In January 2006 the Company acquired BML's gold assets, comprising five separate tenement areas throughout Western Australia, and listed on the ASX in March 2006 after an initial public offering raised $7.5 million.

In April 2009, Chalice announced that it had entered into an agreement to merge with ASX listed company, Sub-Sahara Resources Limited ("Sub-Sahara") through a scheme of arrangement. Sub-Sahara's major asset was its 69% interest in the Zara Project. At the same time, Chalice also entered into an agreement with Africa Wide Resources Limited to acquire an 11.12% interest in the Zara Project. As a result of these transactions Chalice become entitled to 80% in the Zara Project. The remaining 20% interest was held by ASX listed company, Dragon Mining Ltd ("Dragon Mining"). In June 2010 Chalice exercised an option, which it had acquired in March 2010, to purchase the remaining 20% interest in the Zara Project from Dragon Mining. The interest was acquired for $8 million plus two million Chalice shares. Chalice agreed to pay Dragon Mining a further $4 million on delineation of a 1 million ounce ("oz") economically mineable gold reserve at the Zara Project. We note that on 27 April 2012, Chalice announced that subject to the completion of the Proposed Transaction, Chalice and Dragon Mining agreed to set aside the trailing payment in exchange for an up-front one-off payment of $1.5 million.

In November 2010, Chalice announced that as a step towards finalising the mining agreement for the Zara Project the Eritrean Government had advised its intention to purchase, at fair value, a 30% paid participating interest in the project through ENAMCO. This paid participating interest was in addition to ENAMCO's 10% free carried interest.

The terms of the acquisition were announced in June 2011, with ENAMCO agreeing to pay Chalice US$32 million plus approximately US$2 million reimbursement of costs for a 30% participating interest in the Zara Project. The agreement between Chalice and ENAMCO (the "Shareholders Agreement") was entered into in July 2011, under which ENAMCO had agreed to pay the US$32 million by 27 January 2012.

On 25 January 2012 Chalice announced that it has entered into a revised agreement with ENAMCO under which it would pay US$3 million in January 2012 (which was received) and the balance of approximately US$31 million on completion of the Proposed Transaction or by no later than 30 June 2012. If ENAMCO defaults on the payment of the outstanding amount the 30% interest will revert to Chalice.

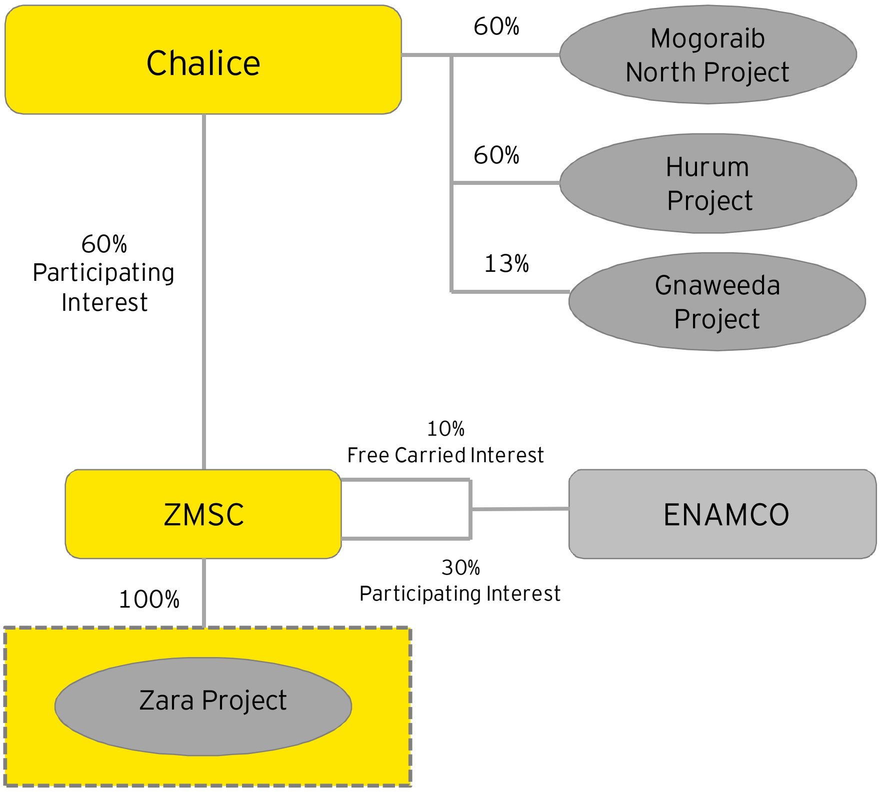
ZMSC, an Eritrean registered company, has existed since 2011 and was officially incorporated on 18 August 2011. Chalice transferred the licences pertaining to the Zara Project from its wholly owned subsidiary, CGM(E), to ZMSC in exchange for a 60% participating interest in ZMSC.

In accordance with the Shareholders' Agreement, Chalice and ENAMCO will contribute to the future development costs of the Koka Gold Mine and to future exploration expenditures on the Zara Project on a 66.7% Chalice and 33.3% ENAMCO basis, which takes into account ENAMCO's 10% free carried interest.

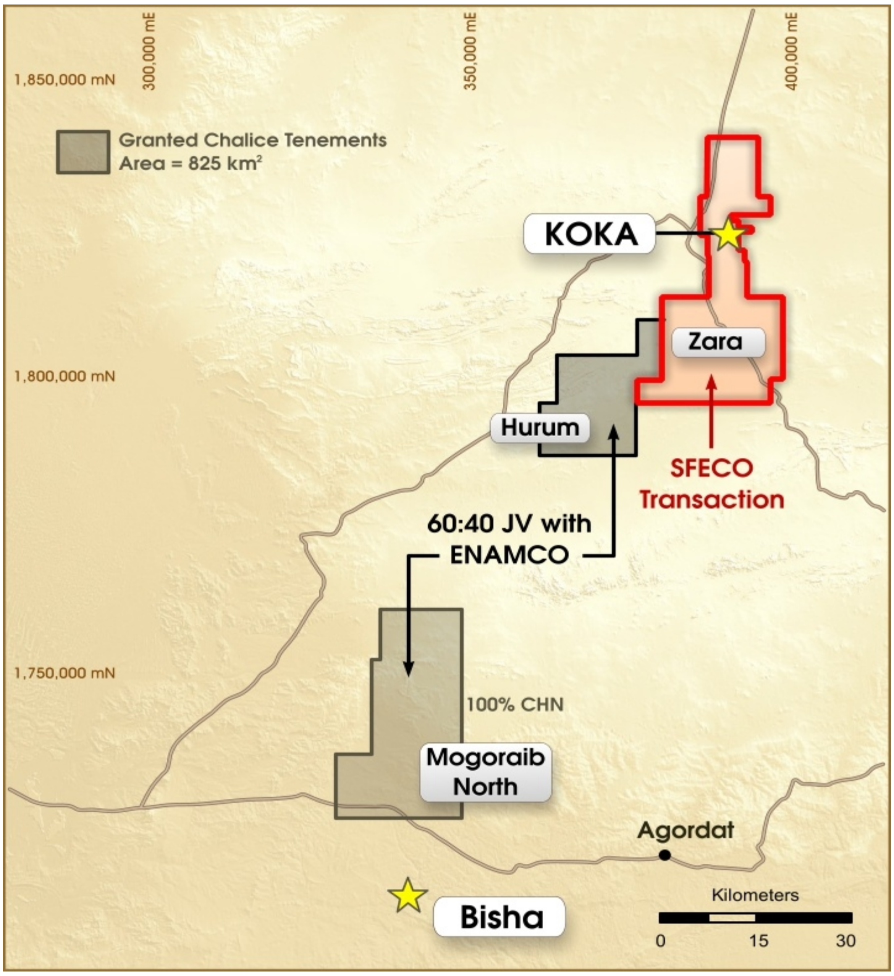
In addition to the 60% ownership interest in the Zara Project, Chalice also has a 60% interest in the Mogoraib North and Hurum licences covering an area in Eritrea of approximately 830km$^2$. These licences were granted in January 2011. Chalice also owns a 13% interest in tenements located in Western Australia as part of the Gnaweeda Project.

Chalice has been dual listed on the TSX since November 2010.

Chalice's interests in its various projects are detailed in the following chart:




The locations of Chalice's tenements in Eritrea are detailed in the following diagram:



### 3.1.1 The Zara Project

The Zara Project is located in northern Eritrea, approximately 160km northwest of the country's capital, Asmara. The Zara Project consists of six exploration licences, including the Zara North, South and Central tenements covering an area totalling 547km$^2$, with 17km$^2$ of that area under two mining leases. The Zara Project includes the undeveloped Koka Gold Mine.

At the time of the completion of the Chalice and Sub-Sahara merger in September 2009, the Zara Project had an Indicated and Inferred Resource of 5.04 million tonnes at 5.8g/t gold for 944,000 oz of contained gold.

In October 2009 Chalice released the results of a scoping study for the Koka Gold Mine, which showed that the mine was financially robust on a gold price of US$800/oz. The scoping study was based on an average annual production of 110,000 ounces at a cash cost of US$424 per oz, for a six year life of mine ("LOM"). The scoping study concluded that an open pit operation was financially more attractive and a lower risk option than underground mining. Based on the positive results of the scoping study, Chalice immediately commenced a definitive feasibility study ("DFS") to further investigate the Koka Gold Mine.

In June 2010, a month before the release of the DFS, Chalice announced the Koka Deposit's maiden ore reserve. A summary of the reserves and resources for the Koka Deposit are included in the table below, shown on a 100% ownership basis. The stated Indicated Resources are inclusive of the Reserves. The mineral resources were estimated using a 1.2g/t gold cut-off.

| **Chalice - Reserves and Resources** | **Mt** | **Grade (g/t Au)** | **Contained Au (oz)** |
|---|---|---|---|
| **Koka Deposit:** | | | |
| Reserves - Probable | 4.6 | 5.1 | 760,000 |
| Indicated Resources (inclusive of Reserves) | 5.0 | 5.3 | 840,000 |

*Source: Chalice 2011 Annual Report*

The results of the DFS released in July 2010 provided further support to the potential development of the Koka Gold Mine as an economically viable gold project. The key parameters and outcomes of the DFS were as follows:

- Average LOM total cash operating costs of US$338 per oz of gold;
- Royalties of 5%;
- Production targeted for late 2014;
- Average annual gold production of approximately 104,000 oz per year with gold production totalling 731,000 ozs;
- Forecast mine life of seven years at a mill throughput of 600,000 tonnes per annum, rising to 700,000 tonnes per annum from year five;
- Estimated start-up capital cost of US$122M, with the bulk of the costs forecasts for the mine, treatment plant and other infrastructure;
- A net present value ("NPV") of US$196 million using a real after tax discount rate of 5%, LOM earnings before interest, tax, depreciation and amortisation ("EBITDA") of US$589 million and an after tax internal rate of return ("IRR") of 35% using a gold price of US1,200 per oz; and
- A NPV of US$99 million using a real after tax discount rate of 5%, LOM EBITDA of US$381 million and an after tax IRR of 22% using a gold price of US$900 per oz.

The project schedule for the establishment of the Koka Gold Mine includes 12 months of pre-stripping activities followed by six months of mine production ramp-up. Infrastructure required for the project to proceed includes upgrading to an access road along with the procurement and construction of the accommodation village and the establishment of temporary mining services facilities to support the pre-stripping activities. The overall project was expected to take 24 months from approval of finance to commissioning[2].

Following the completion of the DFS and the signing of the Shareholders Agreement between Chalice and ENAMCO in July 2011, application was made for the Koka Mining Licence. Two mining licences, ML's 01/2012 and 02/2012, covering an area of 16.42km$^2$, including the Koka Gold Mine, were granted in January 2012 and are valid for a minimum of 18 years.

Positive aspects of the Zara Project, including the Koka Gold Mine, include:

- The Koka Deposit has a resource of 840,000 oz at a high grade of 5.3g/t with recoveries expected to be as high 96%;
- The Koka Gold Mine's estimated capital costs are in line with those of other major gold projects;
- The Arabian-Nubian Shield, where the Zara Project is located, extends over most of Eritrea and is both highly prospective (for gold and base metals) and under-explored, which is a positive for the prospectivity of the exploration permits which make up the Zara Project;
- Bisha, a gold and base metals mine owned 60% by Nevsun, began construction in September 2008 and declared commercial production in February 2011. The Zara Project is expected to benefit from precedents set by Nevsun in terms of working with the Eritrean Government and with local industry; and
- The Chalice Board has considerable African experience including Eritrea.

Contrasting these perceived benefits are a number of risks, including:

- Based on the DFS, the development of the Koka Gold Mine will require estimated capital expenditures of US$122 million. With Chalice being responsible for 66.7% of capital expenditures, the Company will need to source funding over the short to medium term of approximately US$81 million. With a market capitalisation based on the closing price on 23 December 2011, the last trading day before the Proposed Transaction was announced, of approximately $75 million, and a cash balance at 31 December 2011 of $3.6 million, securing this level of funding may be difficult and dilutionary for current Chalice shareholders;
- The funds due to Chalice from the Eritrean Government for its 30% ownership interest were deferred from its original agreement date of the end of January 2012 and finance is yet to be obtained for capital costs. Until gold production is established, internal cash flow is minimal;
- Although there is potential for resource expansion and discovery of additional gold deposits, if this does not happen, the value of Chalice and its tenements may decrease; and
- There are risks with operating in a developing country such as Eritrea. The United Nations ("UN") has imposed a number of sanctions on Eritrea.

Further detailed descriptions of ZMSC's mineral assets are contained in the CSA Report (See Appendix F).

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[2] Koka Gold Mine DFS page 1.3

# 3.2 Financial information

## 3.2.1 ZMSC's financial position

A summary of ZMSC's balance sheets as at 1 April 2011, 31 December 2011 and 31 March 2012 ("1Apr11", "31Dec11" and "31Mar12") is presented in the table below. The amounts have been extracted from ZMSC's audited financial statements as at 1Apr11 and management accounts for 31Dec11 and 31Mar12. The amounts for 31Mar12 are also shown in Australian dollars based on an exchange rate of US$:A$ of 0.9652. We note that the financial statements have been prepared in accordance with the accounting standards applicable in Eritrea.

| ZMSC - Summary Balance Sheet (assets and liabilities) | 1Apr11 US$000s | 31Dec11 US$000s | 31Mar12 US$000s | 31Mar12 A$000s |
|---|---|---|---|---|
| **Current assets** | | | | |
| Cash and cash equivalents | - | 1,092 | 1,178 | 1,137 |
| Trade and other receivables | - | 2,973 | 1,780 | 1,718 |
| | - | 4,066 | 2,958 | 2,855 |
| **Non-current assets** | | | | |
| Property, plant and equipment | 1,353 | 1,291 | 1,306 | 1,261 |
| Mine development | 30,627 | 32,859 | 33,531 | 32,364 |
| Exploration and evaluation expenditure | 6,001 | 11,961 | 13,610 | 13,136 |
| | 37,981 | 46,112 | 48,447 | 46,761 |
| Total assets | 37,981 | 50,177 | 51,405 | 49,616 |
| **Liabilities** | | | | |
| Trade and other payables | - | - | 1,453 | 1,403 |
| Shareholder loans - Chalice | - | 8,131 | 7,981 | 7,703 |
| Shareholder loans - ENAMCO | - | 4,066 | 3,990 | 3,852 |
| Total liabilities | - | 12,197 | 13,424 | 12,957 |
| **Net assets** | **37,981** | **37,981** | **37,981** | **36,659** |

Source: ZMSC's audited financial statements as at 1 April 2011 and unaudited management accounts as at 31 December 2011 and 31 March 2012

ZMSC's balance sheet position reflects its nature as a mineral exploration company, with the major balances at 31Dec11 and 31Mar12 being capitalised development, exploration and evaluation costs together with shareholder loans.

We make the following comments in relation to the above:

- Trade and other receivables relate to funds receivable by ZMSC for ENAMCO's share of exploration expenditures;
- Property, plant and equipment was transferred to ZMSC from Chalice with an effective date of 1 April 2011;
- The amount for mine development pertains to the project to date expenditure on the Koka Mining Licence. Costs predominately include acquisition costs, drilling, assay, DFS costs and labour costs, including expatriate and Eritrean staff;

- Exploration and evaluation expenditure relates to the expenditure incurred across the Zara Exploration Areas. As at 1 April 2011, capitalised exploration costs related to the licences in the following amounts:

  - Zara North – US$770,665;

  - Zara South – US$924,097;

  - Zara Central (including Koka South) - US$4,305,874

- Exploration costs related predominately to geochemical sampling, assaying, drilling, helicopter hire charges, geophysics and salaries of exploration staff;

- Shareholder loans to Chalice and ENAMCO pertain to the costs incurred on the Zara Project and charged to ZMSC at cost; and

- At 31 December 2011, ENAMCO has outstanding contributions of approximately US$4.1 million representing its share of exploration and development costs. Chalice has been funding the project since 1 April 2011. Since 31 December 2011, ENAMCO has contributed approximately US$2.2 million and will continue to be the sole contributor until such time as it has met its share of pro-rata costs incurred since 1 April 2011. After ENAMCO have contributed approximately US$4.1 million, both Chalice and ENAMCO will revert to funding the Zara Project on a 66.7%, 33.3% basis.

### 3.2.2 Chalice's financial position

A summary of Chalice's balance sheet as at 31Dec11 and 31Mar12 is presented in the table below. The amounts have been extracted from Chalice's audit reviewed half year financial statements as at 31Dec11 and the unaudited financial statements as at 31Mar12. At those dates the sale of a 30% interest in ZMSC to ENAMCO has not been brought to account given the uncertainty associated with ENAMCO being in a position to pay Chalice the amount outstanding. As such the accounts of Chalice at 31Dec11 and 31Mar12 reflect the Company having a 90% interest in ZMSC.

| Chalice - Summary Balance Sheet (Assets and Liabilities) | | |
|---|---|---|
| **A$000's** | **31Dec11** | **31Mar12** |
| **Current assets** | | |
| Cash and cash equivalents | 3,508 | 4,750 |
| Trade and other receivables | 2,886 | 1,941 |
| | 6,394 | 6,691 |
| **Non-current assets** | | |
| **Financial assets** | 911 | 870 |
| Property, plant and equipment | 1,566 | 1,567 |
| Mine development | 30,692 | 30,394 |
| Exploration and evaluation expenditure | 14,251 | 15,487 |
| | 47,421 | 48,318 |
| Total assets | 53,815 | 55,009 |
| **Current liabilities** | | |
| Trade and other payables | 916 | 1,536 |
| Employee benefits | 93 | 81 |
| Unearned income | - | 2,895 |
| | 1,009 | 4,512 |
| **Non-current liabilities** | | |
| Loans and borrowings | 3,761 | 3,852 |
| Provisions | 48 | 48 |
| | 3,809 | 3,900 |
| Total liabilities | 4,818 | 8,412 |
| **Net assets** | **48,996** | **46,597** |

Source: Chalice's reviewed financial statements for the half year ended 31 December 2011 and the unaudited financial statements as at 31 March 2012

Chalice's balance sheet position reflects its nature as a mineral exploration and development company, with the major balances at 31Dec11 and 31Mar12 being property, plant and equipment and capitalised exploration and development costs related to the Zara Project.

## 3.3 Chalice's share price performance

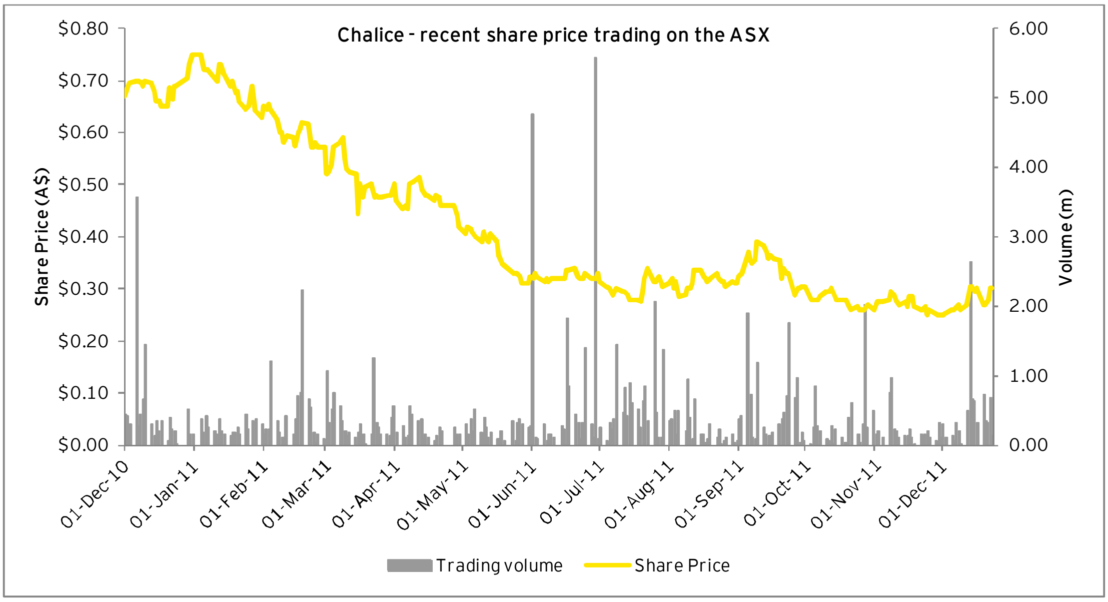
With the Zara Project being Chalice's major mineral asset and undertaking, it is expected that it has had a major impact on the prices at which the Company's shares have traded at on the ASX. The following table summarises the monthly trading prices of Chalice shares on the ASX over the period 1 December 2010 and 23 December 2011, the last trading day prior to the announcement of the Proposed Transaction. The last trading price of a Chalice share on 23 December 2011 was $0.30.

| Chalice - Monthly Share Trading Summary on the ASX | | | | | | |
|---|---|---|---|---|---|---|
| Date | High | Low | Close | Market Cap | Monthly Vol | Liquidity |
| | A$ | A$ | A$ | A$m | millions | % |
| Dec-10 | 0.750 | 0.640 | 0.750 | 158.6 | 10.7 | 5.1% |
| Jan-11 | 0.755 | 0.625 | 0.630 | 133.2 | 4.9 | 2.3% |
| Feb-11 | 0.675 | 0.550 | 0.570 | 121.0 | 8.9 | 4.2% |
| Mar-11 | 0.595 | 0.445 | 0.500 | 108.0 | 8.3 | 3.8% |
| Apr-11 | 0.525 | 0.410 | 0.420 | 91.6 | 4.1 | 1.9% |
| May-11 | 0.430 | 0.305 | 0.325 | 72.3 | 5.1 | 2.3% |
| Jun-11 | 0.350 | 0.300 | 0.330 | 82.5 | 17.6 | 7.0% |
| Jul-11 | 0.345 | 0.275 | 0.305 | 76.3 | 12.7 | 5.1% |
| Aug-11 | 0.345 | 0.255 | 0.310 | 77.5 | 5.7 | 2.3% |
| Sep-11 | 0.390 | 0.260 | 0.305 | 76.3 | 11.2 | 4.5% |
| Oct-11 | 0.300 | 0.250 | 0.260 | 65.0 | 6.8 | 2.7% |
| Nov-11 | 0.310 | 0.240 | 0.250 | 62.5 | 4.6 | 1.8% |
| Up to 23-Dec-11 | 0.345 | 0.250 | 0.300 | 75.0 | 8.2 | 3.3% |

Source: Capital IQ, EY analysis

Chalice is also listed on the TSX, albeit the number of shares registered for trading on the TSX is low compared to the ASX. Because of this the market capitalisation amounts and the liquidity percentages are based on the total number of shares the Company has on issue and only those traded on the ASX.

The chart below shows the daily share price and trading volumes for Chalice between 1 December 2010 and 23 December 2011. The trading price is based on the daily closing price.




Source: Capital IQ, Company announcements

The table and chart show that over the period considered, Chalice's share price traded from a high of $0.75 in December 2010, decreasing to levels of around $0.30 by May 2011, down to $0.255 in August 2011. Chalice's share price increased to $0.39 in September 2011 before falling away to a low of $0.24 in November 2011, before trading upwards to close at $0.30 on 23 December 2011.

Liquidity in Chalice shares on the ASX over the period considered was fairly low with less than 5% of the shares on issue being traded in any one month. December 2010, June 2011 and July 2011 were the only months that had liquidity of greater than 5%, and in two of those months it was only 5.1%.

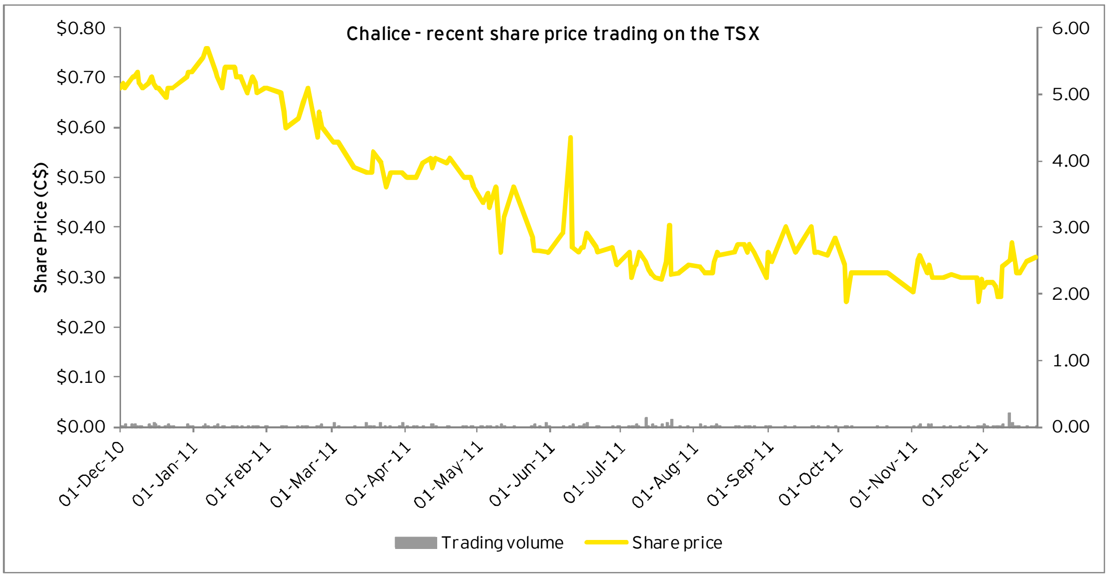
The following table summarises the monthly trading prices of Chalice shares on the TSX over the period 1 December 2010 and 23 December 2011. The last trading price of a Chalice share on 23 December 2011 was C$0.340, or A$0.328 based on the exchange rate on that date.

**Chalice - Monthly Share Trading Summary on the TSX**

| Date | High | Low | Close | Monthly Vol |
|---|---|---|---|---|
| | C$ | C$ | C$ | millions |
| Dec-10 | 0.720 | 0.660 | 0.710 | 0.5 |
| Jan-11 | 0.790 | 0.670 | 0.680 | 0.3 |
| Feb-11 | 0.680 | 0.580 | 0.600 | 0.1 |
| Mar-11 | 0.580 | 0.460 | 0.510 | 0.4 |
| Apr-11 | 0.540 | 0.480 | 0.480 | 0.2 |
| May-11 | 0.490 | 0.300 | 0.350 | 0.2 |
| Jun-11 | 0.580 | 0.325 | 0.330 | 0.3 |
| Jul-11 | 0.410 | 0.270 | 0.325 | 0.6 |
| Aug-11 | 0.365 | 0.300 | 0.300 | 0.2 |
| Sep-11 | 0.400 | 0.330 | 0.380 | 0.1 |
| Oct-11 | 0.380 | 0.200 | 0.310 | 0.0 |
| Nov-11 | 0.355 | 0.250 | 0.295 | 0.2 |
| Up to 23-Dec-11 | 0.375 | 0.260 | 0.340 | 0.5 |

Source: Capital IQ, EY analysis

The chart below shows the daily share price and trading volumes on the TSX for Chalice between 1 December 2010 and 23 December 2011. The trading price is based on the daily closing price.




Source: Capital IQ, Company announcements

The table and chart show that over the period considered, Chalice's share price traded from a high of C$0.79 in January 2011 to a low of C$0.25 in November 2011, closing on 23 December 2011 at a price of C$0.34. Off low trading volumes the trend of prices on the TSX is not dissimilar to the price trend on the ASX across the same period.

In addition to the regular quarterly, interim and annual reporting announcements, the material announcements made by Chalice across the above period that may have had an impact on the Company's share price are summarised below:

- 15 November 2010 – Chalice announced that the Eritrean Government had advised of its intention to purchase at fair value a 30% paid participating interest in the project through ENAMCO. This paid participating interest would be in addition to ENAMCO's 10% free carried interest.

- 27 January 2011 – An announcement was made regarding the issue of two new exploration licences to Chalice in Eritrea. These licences cover 555 $km^2$ near to the Bisha gold and base metal deposit and 275 $km^2$ adjoining Zara South.

- 4 March 2011 – Standard & Poor's announced that Chalice would be added to the All Ordinaries indices.

- 9 May 2011 – Chalice announced that a major new near-mine drilling campaign was due to commence at the Zara Project. The new drilling program, comprising 8-10,000m of diamond drilling, would focus on a series of resistivity anomalies previously detected.

- 26 May 2011 - In May 2011, Chalice placed 32,000,000 shares at $0.30 per share to raise $9.6 million before issue costs.

- 16 June 2011 – Chalice announced that it had reached an agreement with ENAMCO for the acquisition of a 30% participating interest in the Zara Project. Under the agreement ENAMCO agreed to pay Chalice US$32 million for a 30% participating interest in the Zara licences, which is to be represented by an interest in ZMSC. In addition, ENAMCO agreed to pay Chalice approximately US$2 million for the reimbursement to Chalice of ENAMCO's pro-rata share of exploration costs expended to date on the Zara Project which fall outside of the Koka mining licence.

- 22 December 2011 - An announcement was made regarding the intercept of high grade gold mineralisation at the Koka South discovery, which is located immediately south of the Koka gold deposit.

# 4. Overview of SFECO

China Shanghai (Group) Corporation for Foreign Economic & Technological Cooperation (i.e. SFECO) is a Chinese State owned diversified conglomerate with headquarters in Shanghai. SFECO specialises in five industry sectors: Civil Engineering, Industrial Engineering, Agricultural Engineering, Engineering Related Tendering & Consultancy Services and Trade. The net assets of SFECO Group are estimated to be US$1.2 billion and its total assets are approximately US$5.1 billion. The company has regional offices in Vietnam and Iran.

SFECO is involved in 16 joint venture enterprises, has six holding companies and seven wholly owned subsidiaries. The core business of SFECO is its Industrial Engineering services, having successfully completed approximately 600 projects overseas, including the Zawgyi Dam Hydroelectric Power project in Burma, the Durgun Hydroelectric Power Station in Mongolia, Son Dong Thermal Power Plant in Vietnam, and the BNS Steel Factory in Thailand, and Liquefied Petroleum Gas Stage in Pakistan.

SFECO's immediate holding company is Shanghai Industrial Investment (Holding) Co. Ltd. ("SIIC"), which owns several listed companies and enterprise subsidiaries both in China and overseas, with nine overseas regional headquarters. The registered capital of SIIC is HK$2 million and the total assets of SIIC are approximately HK$50 billion. SIIC is wholly owned by Shanghai Construction Group.

Shanghai Construction Group has been involved in the construction and development industry for over 50 years. The company is 70% state owned, with the remaining 30% publically owned on the Shanghai Stock Exchange. In recent years Shanghai Construction Group has achieved an annual turnover increase of more than 20% as a result of improvements and developments within its construction contracting and construction-related divisions, as well as its real-estate and public utilities and infrastructure investment and managements divisions.

Shanghai Construction Group has been involved in various landmark projects since the 1990's, including the Lu Pu Bridge (the steel-arch bridge with the longest span in the world), Shanghai Maglev (the world's first commercial maglev line), East China Sea Bridge ( China's first trans-ocean bridge), the 468m-high Oriental Pearl TV Tower and the 420.5m-high Shanghai Jin Mao Tower.

Shanghai Construction Group acquired Shanghai Foreign Group Holding Co. Ltd in 2011, a Chinese construction company, concurrently with its 100% acquisition of Shanghai Municipal Engineering Design General Institute (Group) Co. Ltd, a China based urban design company. The acquisition was performed through the issue of shares to the value of approximately US$261.4 million[3].

Additional detail in relation to SFECO is contained in the Explanatory Statement.

[3] Mergermarket Ltd

# 5. Gold industry profile

## 5.1 Description

Gold is a precious metal, which as well as being a store of value, is used in jewellery, electronics and dental applications. Gold predominantly occurs in a metallic state and is commonly associated with sulphide minerals. Global gold production is typically sourced from open pit mines. Underground mining is undertaken when the depth of the ore below the surface renders open pit mining uneconomical.

The processing technique applied, either free milling or refractory, is dependent on the nature of the ore. Free milling ore is ore from which gold can be removed by crushing, grinding and cyanidation without the need for additional processing. Refractory ore is ore where gold is locked in the sulphide minerals such that additional processing, including roasting or biological leaching, is required before cyanidation to achieve satisfactory levels of gold recovery. After processing, gold is smelted and refined.

## 5.2 Demand and Supply Conditions

### Gold Demand

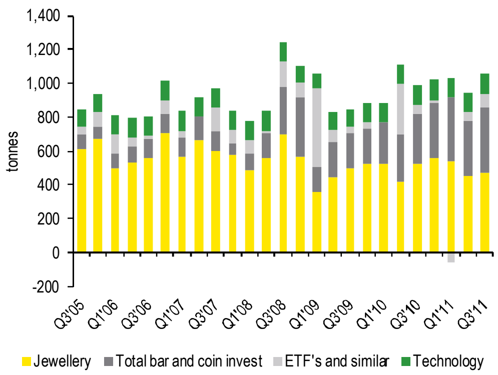
Gold is often seen as a natural hedge, given that the gold price has historically been negatively correlated to general economic conditions. This observation is often based on the following views:

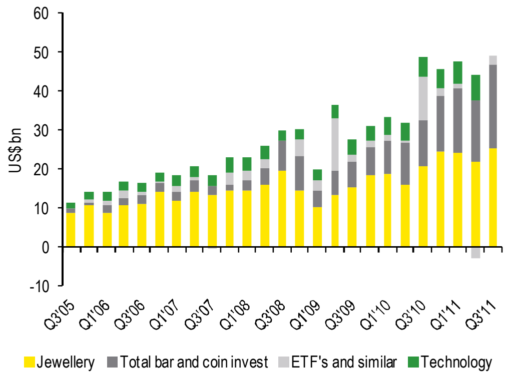
- gold is a store of value for risk-averse investors during periods of uncertainty. Increases in gold demand occurred while there has been ongoing uncertainty surrounding the increase in public sector debt in some major economies, natural disasters in Japan, political uncertainty in the Middle East and foreign exchange rate fluctuations. In addition, during the global financial crisis ("GFC"), demand for gold increased as an investment asset; and

- gold is a hedge against inflation. Increases in gold demand have historically occurred while there have been rising oil and food prices and ongoing expansionary monetary policy in many developing economies, such as China and India.

Following strong demand for gold in 2008, global demand for gold decreased to 3,617 tonnes in FY09 and increased to 3,999 tonnes in FY10. Gold demand for the third quarter of 2011 was 1,053.9 tonnes, which represents a 6% year on year. The graphs below show the demand for gold by quantity and price.

**Historical gold demand**




*Source: World Gold Council*

During the 12 months ended Q3 2010 and the 12 months ended Q3 2011, there was an increased demand for gold from India, China and Europe. For the 12 month ended Q3 2011, India and China together accounted for almost half of global end-user investment and 44% of global jewellery demand.

**Consumer demand in selected countries: four-quarter totals**

| | 12 months ended Q3'10 | | | 12 months ended Q3'11 | | | Year on Year % chg | | |
|---|---|---|---|---|---|---|---|---|---|
| *Gold tonnes* | Jewellery | Total bar and coin invest | Total | Jewellery | Total bar and coin invest | Total | Jewellery | Total bar and coin invest | Total |
| India | 619 | 305 | 924 | 650 | 409 | 1,059 | 5 | 34 | 15 |
| Greater China | 448 | 153 | 601 | 542 | 267 | 809 | 21 | 74 | 35 |
| Middle East | 211 | 27 | 239 | 172 | 32 | 204 | (19) | 17 | (14) |
| Turkey | 72 | 38 | 110 | 71 | 69 | 140 | (1) | 81 | 27 |
| USA | 138 | 116 | 254 | 119 | 94 | 214 | (13) | (19) | (16) |
| Europe ex CIS | - | 253 | 253 | - | 323 | 323 | - | 28 | 28 |
| Total above | 1,488 | 893 | 2,380 | 1,554 | 1,195 | 2,749 | 4 | 34 | 15 |
| Other | 489 | 322 | 550 | 471 | 381 | 591 | -4 | 19 | 7 |
| **World total** | **1,977** | **1,214** | **2,930** | **2,025** | **1,576** | **3,340** | 2 | 30 | 14 |

*Source: GFMS, World Gold Council*

### Gold Supply

Primary sources of gold supply are mining and recovery from scrap. From 2007 to 2009 scrap supply (largely from recycled jewellery) increased whereas mine supply remained largely stable.

| *Gold tonnes* | 2007 | 2008 | 2009 | 2010 | CAGR (%) |
|---|---|---|---|---|---|
| Mine supply | 2,476 | 2,409 | 2,589 | 2,686 | 2.7 |
| Scrap supply | 956 | 1,217 | 1,695 | 1,651 | 20.0 |
| Official sector net sales | 484 | 236 | 34 | (77) | (154.2) |
| Net producer hedging | (444) | (349) | (236) | (108) | (37) |
| **Total** | **3,472** | **3,513** | **4,081** | **4,151** | **6** |

*Source: World Gold Council*

In Q3 2011 the total supply of gold reached 1,034.4 tonnes, which represents a 2% increases than year earlier results. Mine production increased by 5% during Q3 2011with African, the Commonwealth Independent States ("CIS") and Latin American based producers contributing largely to the increase. In Africa production increased as a result of the establishment of the new Essakane mine in Burkina Faso, along with a ramp up of production at the Inata mine. Production in the CIS region was a result of increased production in Russia and Kazakhstan, following the ramp up of Blagodatnoye, Malomir and Altyntau Kokshetau mines.

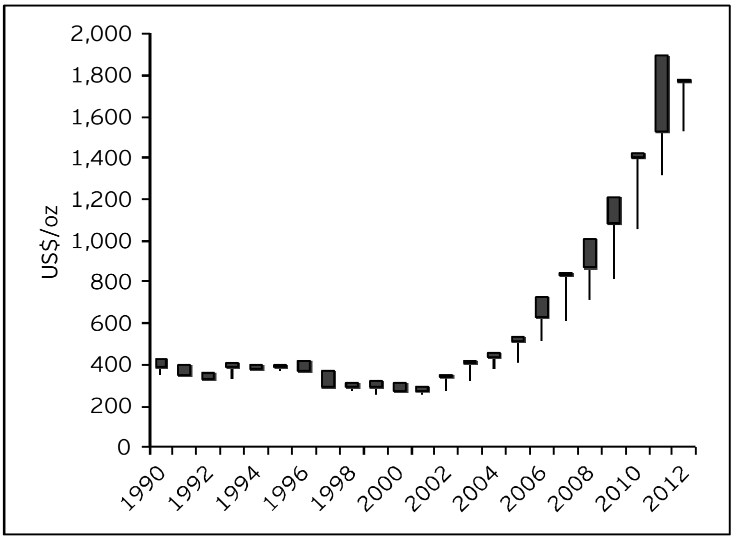
## 5.3 Price Analysis

### Historical

Despite challenging economic conditions and the impact of this on markets around the world, during 2011 gold prices reached historical highs. In September 2011 the price reached US$1,898/oz resulting in investment analysts revising their estimates of long-term gold price forecasts.

The strength of the gold price was partially driven by further deterioration of Greek finances and its potential ripple effect on larger European Union ("EU") member countries, coupled with the possibility of a technical default by the United States on its government debt. In unstable economic times such as these investors perceived gold as an asset that is capable of preserving capital and protecting against tail risks[4]. This resulted in increased demand and pushed gold prices to record highs.

In nominal dollars over the five years 1991 to 1995 the average gold price was approximately US$367/oz, over the five years 1996 to 2000 was approximately US$314/oz, over the five years 2001 to 2005 was approximately $360/oz, and over the five years 2006 to 2010 was approximately US$874/oz. Details of the historical price of gold, in nominal US dollars, over the 22 years from 1990 to February 2012, are set out below.




Source: World Gold Council

[4] World Gold Council, Investment Statistics Commentary, January 2012

**Outlook**

The world gold price is forecast to increase on average in 2012 compared to 2011 prices. This is supported by a number of factors including low interest rates in the US and Europe, changes to the balance of some central bank portfolios, and continued investment and fabrication demand from consumers in developing economies[5]. Consensus forecast for gold are presented below.

**Consensus estimate forecast gold price[6]:**

| Gold Prices - US$/oz | 2012E | 2013E | 2014E | 2015E | 2016E | LT (2012$) |
|---|---|---|---|---|---|---|
| Average | 1,781 | 1,811 | 1,746 | 1,577 | 1,438 | 1,278 |
| Median | 1,800 | 1,800 | 1,766 | 1,538 | 1,425 | 1,200 |
| High | 1,925 | 2,000 | 2,038 | 1,800 | 1,600 | 1,800 |
| Low | 1,622 | 1,611 | 1,550 | 1,375 | 1,300 | 1,025 |

Source: Analyst Reports

The spot price for gold on 1 May 2012 was approximately US$1,660.

## 5.4 Eritrea

Eritrea is located in the Horn of Africa, with the Red Sea coastline making up its eastern border, the country is bordered by Sudan in the west, Ethiopia in the south and Djibouti in the southeast. Eritrea contains proven reserves in gold, potash, zinc, copper and salt, with more than a dozen foreign companies looking to explore or mine gold following the opening of the Bisha mine in western Eritrea in February 2011. All mineral resources belong to the State and investors must obtain permits from the Government before performing any prospecting, exploration or development activities.

Eritrea follows an authoritarian system of politics, with the Peoples' Front for Democracy and Justice ("PFDJ") being in government for many years. The PFDJ is led by President Isaias Afewerki, who has held the position since 1993. Due to some of the alleged past actions of the Eritrean Government, the UN has imposed a number of sanctions on Eritrea.

The taxation system in Eritrea is often difficult for foreign investors to understand. The Government relies on a voluntary 2% tax on the income of Diaspora Eritreans as one of its main sources of income, and at times sets taxes on individuals and businesses without warning. Eritrea's operational environment is relatively corruption-free however it can be difficult for foreign investors to transact due to the country's legal system and standard of infrastructure. Following the 1998-2000 border war with Ethiopia, foreigners, including those permanently based in Eritrea, are at times restricted from travelling freely.

The consumer price index change in 2009 was approximately 33%; however, it is forecast to decrease to approximately 12.3% over the coming five years. Given its ongoing sensitive relationship with Ethiopia, and at times the international community, Eritrea does not have any significant export trade partners. The lack of major exports and a shortage of hard currency have caused the cost of living in Eritrea to increase significantly in recent years, causing the Government to ration fuel and establish a network of "fair price" shops to allow certain essentials to remain affordable for the general public[7].

[5] Resources and Energy Quarterly, Australian Government: Bureau of Resources and Energy Economics, December Quarter 2011 volume 1 number 2.
[6] Prices are stated on a nominal, fiscal year basis.
[7] IHS Global Insight – Country Intelligence Report Eritrea – 13 February 2012.

# 6. Valuation methodology and approach

## 6.1 Definition of fair value

In forming our opinion as to whether or not the Proposed Transaction is fair and reasonable to Chalice Shareholders, we have assessed the fair value of the Company's 60% interest in ZMSC in order to compare that amount with the Cash Consideration being offered by SFECO. Fair value is generally defined as:

*"the price at which an asset could be exchanged between a knowledgeable and willing but not anxious seller and a knowledgeable and willing but not anxious buyer both acting at arm's length"*

Our assessment of the fair value of ZMSC has been done on a basis consistent with this definition. As SFECO is acquiring a controlling interest in ZMSC, in assessing the fair value of ZMSC we have assumed 100% ownership, which implicitly includes a control premium.

With respect to the Cash Consideration being offered by SFECO we have taken into account the tax payable by Chalice to the Eritrean Government on the disposal of the 60% interest in the Zara Project. Accordingly, our comparison of values includes the Cash Consideration net of the estimated tax payable.

## 6.2 Valuation methodology and approach

RG 111 provides guidance on the valuation methods that an independent expert should consider when valuing a company. These methods include the:

- Discounted cash flow ("DCF") method and the estimated realisable value of any surplus assets;
- Application of earnings multiples (appropriate to the business or industry in which the entity operates) to the estimated future maintainable earnings or cash flows of the entity, added to the estimated realisable value of any surplus assets;
- Amount that would be available for distribution to security holders on an orderly realisation of assets;
- Quoted price for listed securities, when there is a liquid and active market and allowing for the fact that the quoted price may not reflect their value, should 100% of the securities be available for sale;
- Recent genuine offers, if any, received by the target for any business units or assets as a basis for valuation of those business units or assets; and
- Amount that any alternative acquirer might be willing to offer if all the securities in the target were available for purchase.

Each methodology is appropriate in certain circumstances. The decision as to which methodology to apply generally depends on the nature of the asset being valued, the methodology most commonly adopted in valuing such an asset and the availability of appropriate information.

The DCF methodology involves calculating the net present value of cash flows that are expected to be derived from future activities. The forecast cash flows are discounted by a discount rate that reflects the time value of money and the risk inherent in the cash flows. This methodology is particularly appropriate in valuing projects, businesses and companies that are in a start up phase and/or are expecting considerable volatility or growth in earnings, as well as businesses with a finite life (such as mining projects). The utilisation of this methodology generally requires that the asset be sufficiently advanced to enable management to provide long term cash flows with some degree of robustness.

The capitalisation of earnings methodology involves capitalising the earnings of a project, a business or a company at an appropriate multiple, which reflects the risks underlying the earnings together with growth prospects. This methodology is theoretically most appropriate where a company or business is expected to generate a relatively stable level of earnings but in practice, is also frequently used in a range of other circumstances.

The net asset backing methodology involves consideration of the net realisable value of the assets of a business or company on a going concern basis, assuming an orderly realisation of those assets. This value includes a discount to allow for the time value of money and for reasonable costs of undertaking the realisation. It is not a valuation on the basis of a forced sale, where assets may be sold at values materially different to their fair value. This methodology is appropriate where a project, a business or company is not making an adequate return on its assets or where there are surplus non-operational assets. This method is also appropriate for companies that are holding assets that are not sufficiently advanced to enable the preparation of long term cash flow forecasts.

Market based assessments relate to the valuation of companies, the shares of which are traded on a stock exchange. While the relevant share price would, prima facie, constitute the market value of the shares, such market prices usually reflect the prices paid for small parcels of shares and as such do not include a control premium relevant to a significant parcel of shares.

## 6.3 Valuation methodology adopted

Given the nature of ZMSC as a gold exploration and development company, we have assessed the value of the company on a net asset backing basis after considering the underlying value of its assets and liabilities on a going concern basis. In adopting this approach, a key component of the valuation is the assessment of the value of ZMSC's mineral assets, including the Koka Gold Mine and surrounding exploration licences. The methods applied to value ZMSC's mineral assets primarily reflect the stage of development of each asset. Details of the methods adopted are summarised in the remainder of this section.

Prior to finalising our valuation conclusion, we considered the reasonableness of our overall valuation range by the comparison against trading multiples of companies with similar projects to the Zara Project. We have also compared the valuation range to the historical share price of Chalice prior to the announcement of the Proposed Transaction. Although the ownership of 60% of ZMSC was not the only asset held by Chalice at the time of the announcement of the Proposed Transaction, its interest in the Koka Gold Mine contributed to the majority of the value of Chalice's share price according to analysts leading up to the announcement.

### 6.3.1 The Koka Gold Mine

The undeveloped Koka Gold Mine is an advanced stage project that has been subjected to a definitive feasibility study. For the purpose of this report, we have valued the Koka Gold Mine on a DCF basis. We have adopted this methodology for the following key reasons:

- Long term LOM operational and financial forecasts are available, having been compiled as part of the DFS that was completed in July 2010;
- The mine has a finite life based on available reserves; and
- The DCF methodology enables us to better consider different scenarios in relation to pricing, foreign exchange and operational assumptions.

In considering the Koka Gold Mine, we had CSA undertake a technical review of the DFS, the purposes of which was to consider the technical assumptions upon which the DFS was based and the reasonableness of the outcomes.

### 6.3.2 The Zara Exploration Areas

The Zara Exploration Areas have been valued by CSA. Section 4.1 of the CSA Report details the different valuation methods used in valuing mineral assets that are at exploration stage. In valuing the Zara Exploration Areas, CSA has determined the Appraised Value Method as being the most appropriate. This method utilises a Multiple of Exploration Method which involves the allocation of a premium or discount to the past expenditure incurred through the application of a Prospectivity Enhancement Multiplier ("PEM"). The selection of a PEM relates to the success or failure of the exploration completed to date. Further detail on this methodology is contained in Section 4.1 of the CSA Report, which is contained in Appendix F.

### 6.3.3 Other assets and liabilities

The value of ZMSC's other assets and liabilities such as cash, property, plant and equipment and shareholder loans, was considered to be commensurate with their book values.

# 7. Valuation of ZMSC

## 7.1 Valuation of the Koka Gold Mine

### 7.1.1 DCF valuation

In valuing the Koka Gold Mine on a DCF basis we have considered the forecast LOM cash flows prepared by Chalice management to reflect the outputs of the DFS (the "LOM Model"). The LOM Model includes estimates of the Koka Gold Mine's ungeared after tax real cash flows across the life of the mine to 2022. The LOM Model has been prepared based on:

- The DFS completed in July 2010 based on JORC compliant ore reserves of 760,000 oz;
- Development commencing in FY12, with first production expected in FY14;
- Forecast mine life of seven years at a mill throughput of 600,000 tonnes per annum, increasing to 700,000 tonnes per annum from year five; and
- Average annual gold production of approximately 104,000 oz per year with LOM gold production totalling 731,000 oz.

We engaged CSA to assist us in our consideration of the technical aspects underpinning the LOM Model. The aspects considered by CSA included:

- the planned mine, processing, utility and transport infrastructure;
- the forecast capital expenditure associated with the establishment of the Koka Gold Mine (inclusive of infrastructure);
- forecast production volumes, grade, recovery, blending (any geotechnical aspects that may be specific to Koka Gold Mine) and depletion of resource;
- forecast operational expenses for mining, processing, transport and general and administration;
- forecast time to development; and
- environmental issues and stage of approval.

With respect to forecast gold prices we have used consensus estimates based on an analysis of a number of broker reports available as at 31 March 2012.

We note that we have not audited the LOM Model, however we have performed the following:

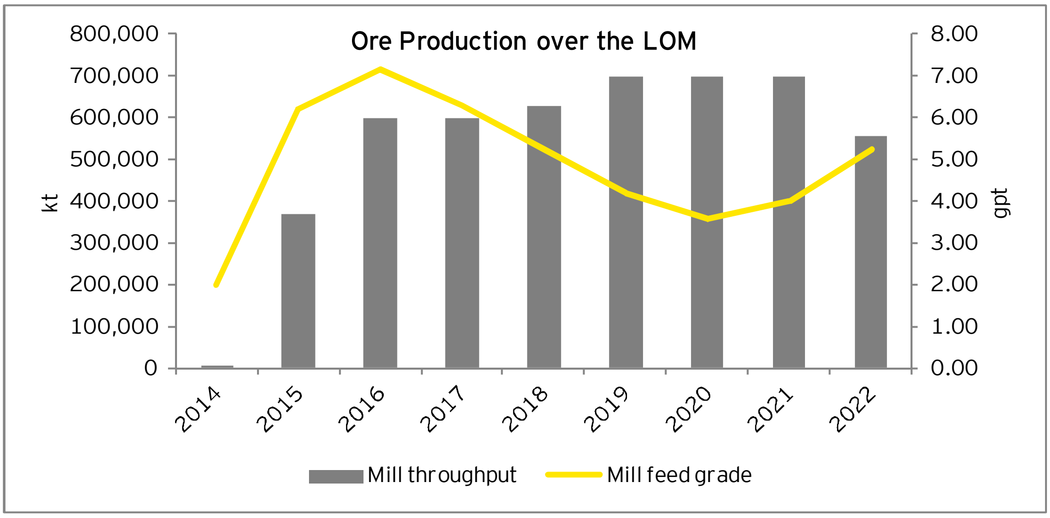
- Held discussions with Chalice management regarding the preparation of the LOM Model and the assumptions underlying the projections; and
- We have performed limited analytical procedures regarding the mathematical accuracy of the model.

Outlined below are details of key assumptions associated with the valuation of the Koka Gold Mine. We note that forecast cash flows reflect a 100% interest in the Koka Gold Mine and represent the development scenario outlined in the DFS as the base case, adjusted so that the cash flows commence on 1 April 2012.

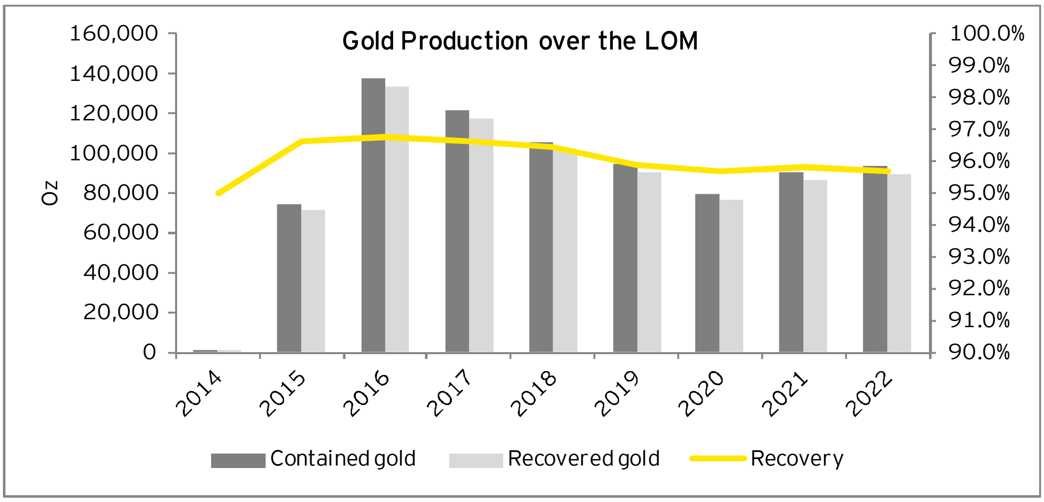
### Revenue

### Production

Production volumes forecast over the LOM are shown in the charts below, with total production 4.9 million tonnes ("Mt") of ore resource with a mill feed grade averaging 5.1 grams of gold per tonne ("grams/t"). The LOM Model obtained from Chalice included total contained gold, based on probable reserves, of 760,000 oz. To account for the possible conversion of indicated resources to reserves, we have extended forecast production to include additional JORC compliant resources not originally included in the LOM Model. This increased the contained gold to an estimated 796,000 oz. With a recovery averaging approximately 96%, the Koka Gold Mine is forecast to produce a total of 766,000 oz of gold across the LOM, compared to the original 731,000 ozs.




Source: Chalice LOM Model




Source: Chalice LOM Model

In relation to the above charts we note the following:

- The LOM plans were developed based the Koka Gold Mine DFS and the JORC reserve estimate;
- We have increased production by an estimated 221,000 tonnes, realising an additional 35,000 oz of gold, to account for expectation that a level of indicated resources not included in the LOM Model will be converted to reserves;

- Removal of waste ore commences in FY13, with a strip ratio averaging 10.1 over the LOM;
- Production of ore commences in FY14, with a ramp up period of nine months with quarterly production reaching 143,000 tonnes by Q3 FY15;
- Thereafter production averages 600,000 tonnes to 700,000 tonnes per annum, with the exception of the final year of production in FY22 estimated at 363,000 tonnes;
- The mill feed grade ranges from 1.97 grams/t (in the first quarter when production is ramping up) to 7.62 grams/t, averaging 5.10 grams/t over the LOM;
- Recovery is estimated to be between 96% and 97% throughout the LOM; and
- A total of 766,000 oz is forecast to be produced from contained gold of 796,000 oz which corresponds to the mine's JORC compliant reserve of 760,000 oz from 4.5 Mt of ore and JORC indicated resources of 840,000 oz from 5.0 Mt of ore.

**Forecast gold prices**

Consensus estimates of real gold prices are forecast to decrease from US$1,750 per ounce in FY12 to a long term price of US$1,200 per ounce from beyond FY15. The gold price estimates, in real terms, that we have applied in our valuation of the Koka Gold Mine are as follows:

| US$/oz | 2012 | 2013 | 2014 | 2015 | Long term |
|---|---|---|---|---|---|
| Gold | 1,750 | 1,691 | 1,538 | 1,319 | 1,200 |

Source: Consensus analyst forecasts and EY analysis

The forecast revenue by adopting consensus estimate gold prices over the first five fiscal years and the total over the LOM is summarised in the table below.

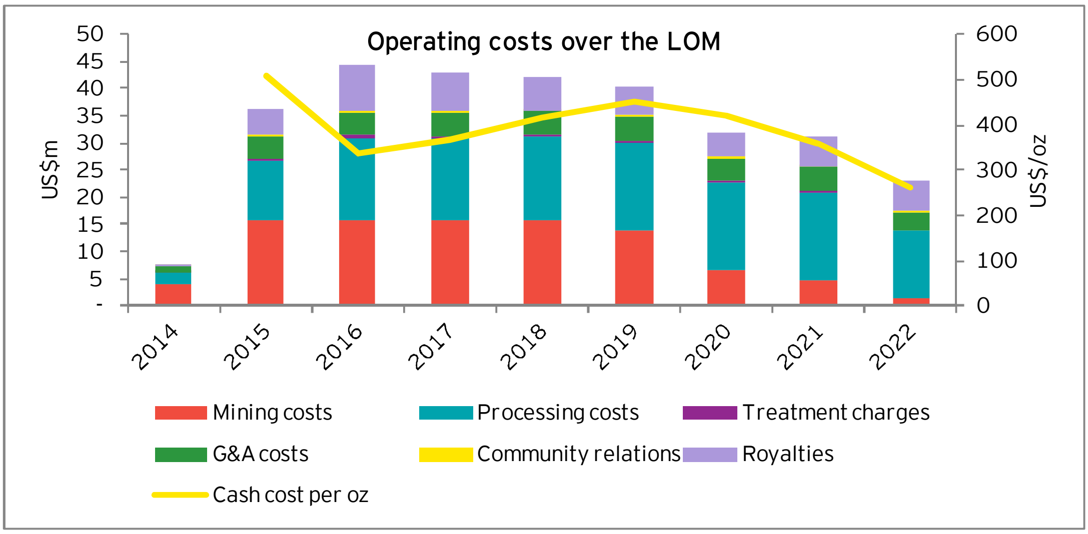
| | | 2014 | 2015 | 2016 | 2017 | 2018 | Total LOM |
|---|---|---|---|---|---|---|---|
| Recovered gold | oz | 210 | 71,444 | 133,296 | 117,212 | 101,474 | 765,587 |
| Gold price | US$/oz | 1,538 | 1,319 | 1,280 | 1,240 | 1,200 | 1,231 |
| Gold revenue | US$m | 0.3 | 94.3 | 170.6 | 145.3 | 121.8 | 942.6 |

Source: Chalice LOM model and EY analysis

### Operating costs and other general and administration costs

The LOM Model includes forecast real cash costs for the Koka Gold Mine. Operating costs include costs associated with mining, processing, treatment charges, royalties, community relations and administration.

The following chart summarises the forecast operating costs for Koka Gold Mine out to FY22. Due to low production volumes in FY14 as the mine commences, the cash cost per ounce is not displayed as it is not meaningful.




Source: Chalice LOM Model, CSA and EY analysis

In relation to the above chart we note the following:

- The cash cost per ounce averages of US$338/oz over the LOM. The cash cost per ounce excludes royalties and community relation costs;
- Mining costs are estimated at an average of US$123/oz, with processing costs estimated at an average of US$157/oz;
- Removal of waste which commences is treated as a pre-production cost and is included in capital expenditure rather than shown as a mining cost; and
- Treatment costs are estimated at US$4.0/oz, administration costs are estimated at US$4.3 million per annum, community service levies are charged at US$2.50/oz. and royalties are charged at 5.0% of revenue.

### Capital expenditure

Given that the Koka Gold Mine is yet to be developed, the majority of capital expenditure will be incurred on the initial development of the mine and the establishment of the treatment plant and associated infrastructure. The level of sustaining capital forecast across the LOM is forecast to be minimal. The capital expenditure forecast for the first five years of the Koka Gold Mine are summarised in the table below.

| | | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total LOM |
|---|---|---|---|---|---|---|---|---|
| Growth | US$m | 10.5 | 51.5 | 60.0 | - | - | - | 122.0 |
| Sustaining | US$m | - | - | 0.9 | 2.6 | 0.7 | 2.1 | 9.3 |
| Total capex | US$m | 10.5 | 51.5 | 60.8 | 2.6 | 0.7 | 2.1 | 131.3 |

Source: Chalice LOM model and EY analysis

In relation to the above table we note the following:

- The forecast capital expenditure to be incurred establishing the Koka Gold Mine is based on estimates prepared by Lycopodium, as presented in the DFS; and
- Sustaining capital expenditure has been estimated by Chalice management.

### Taxation

The corporate tax rate has been estimated at 38%, being the corporate tax rate for Eritrea.

### Discount rate

We adopted a US$ denominated real post-tax discount rate range of 13.0% to 15.0% to apply to the forecast cash flows within the LOM Model and adopting a mid-period discounting period. A detailed description of the discount rate determination is set out in Appendix A.

### Valuation of Koka Gold Mine

Applying the key assumptions above, we valued the Koka Gold Mine on a 100% basis in the range of US$107.8 million to US$125.3 million with a midpoint value of US$116.5 million.

### Valuation of Chalice's interest in the Koka Gold Mine

While Chalice has a 60% interest in the Zara Project, given ENAMCO's 10% free carried interest, Chalice is required to fund 66.7% of the upfront capital expenditure, with ENAMCO funding the remaining 33.3%.

To account for the additional capital expenditure that Chalice is required to fund, in assessing the value of the Company's 60% interest in the Koka Gold Mine, we have calculated the net present value of the incremental capital expenditure to be incurred by Chalice and deducted the amount from the value of Chalice's interest.

Based on the assumptions in the LOM Model, we calculated the following fair value of Chalice's 60% interest in the Koka Gold Mine, including consideration of Chalice's requirement to find 66.7% of capital expenditures (shown below as the NPV of additional capital expenditures required)

| US$ millions | Low | High | Midpoint |
|---|---|---|---|
| NPV of the Koka Gold Mine on a 100% basis | 107.8 | 125.3 | 116.5 |
| NPV of the Koka Gold Mine at Chalice's 60% interest | 64.7 | 75.2 | 69.9 |
| Less: NPV of additional capital expenditures required | (7.1) | (7.2) | (7.2) |
| Total of Chalice's interest in the Koka Gold Mine | 57.6 | 68.0 | 62.8 |

Source: EY analysis

The fair value range above represents the fair value of the Koka Gold Mine, based on the LOM Model provided by Management, adjusted for forecast gold prices, our preferred range of discount rates and the inclusion of additional JORC compliant resources not originally included in the LOM.

**Adjustments to the LOM Model**

To assist us in our assessment of the LOM Model and the assumptions upon which it is based, we engaged CSA to undertake a review of the DFS and the key outputs which underpin the LOM Model. From this review, CSA were of the view that some of the operating and capital cost estimates included in the LOM Model should be adjusted to reflect more recent cost estimates. In addition, given the timing of the Proposed Transaction there is the possibility that the development of the Koka Gold Mine could be delayed. On this basis we have adjusted the LOM Model to allow for the following matters:

- An increase to annual operating costs of $4.4 million per annum to account for increased costs for such items as fuel and explosives;
- An increase to capital expenditure of $1.5 million over two years as an additional contingency; and
- Included one scenario where the project is delayed by six months.

Based on discussions with Chalice management, they are of the view that to take advantage of higher short term gold prices, there is the possibility that the mine plan for the Koka Gold Mine could be revised to increase the tonnes processed in the earlier years of operation. To reflect this, Chalice provided us with a revised production profile which has production increasing to 700,000 tpa in 2015 compared to 2018 in the DFS, and to 800,000 tpa by 2018. This brings forward production by 63,000 ozs in the first four years of operation. We note that the revised production profile results in a similar volume of gold produced as compared to Chalice's original, unadjusted, LOM Model.

The table below illustrates the range of fair values assessed for the Koka Gold Mine using the LOM Model adjusted for the various items and scenarios discussed above.

| | | 100% interest | | Chalice's interest | |
|---|---|---|---|---|---|
| | | Discount rate | | | |
| US$ millions | Scenario | 13.0% | 15.0% | 13.0% | 15.0% |
| Chalice's LOM Model | A | 125.3 | 107.8 | 68.0 | 57.6 |
| Chalice's LOM Model with additional resources | B | 132.0 | 113.5 | 72.0 | 61.0 |
| Additional resources and CSA adjustments | C | 119.9 | 102.3 | 64.7 | 54.2 |
| Additional resources, 6 month delay and CSA adjustments | D | 104.3 | 87.0 | 55.7 | 45.5 |
| Chalice's LOM Model with early ramp up | E | 139.5 | 122.2 | 76.5 | 66.2 |

Source: EY analysis
*Chalice's 60% interest includes a deduction for the additional 6.7% of funds required by Chalice to fund the project's capital expenditures.

Scenario A – Chalice's LOM Model adjusted for our preferred commodity prices and discount rates.

Scenario B – Same as Scenario A with the inclusion of an additional 35,000 oz of gold at the end of the LOM (from inclusion of additional resources).

Scenario C – Same as Scenario B with the increases in operating costs and capital expenditures suggested by CSA.

Scenario D – Same as Scenario C with a delay of the development by six months.

Scenario E – Same as Scenario A with a revised production profile that adopts an earlier processing throughput of 700,000 tpa with a maximum throughput of 800,000 tpa (i.e. no additional gold, no additional costs and no delay).

In considering the base case and taking the adjustments and scenarios into account, the value of the Koka Gold Mine on a 100% basis ranges from US$87.0 million to US$139.5 million and US$45.5 million to US$76.5 million for Chalice's 60% interest.

In considering the range of values, for the purpose of assessing the fair value of Chalice's interest in ZMSC, we have adopted a fair value range of US$60.0 million to US$70.0 million as being representative of the value of Chalice's 60% interest in the Koka Gold Mine. This range effectively represents the third quartile of the full range determined across all scenarios considered.

## 7.2 Valuation of the Zara Exploration Areas

The value of the Zara Exploration Areas, being that part of the Zara Project outside of the Koka Gold Mine, has been assessed by CSA. The areas valued by CSA are comprised of the following:

- Koka South prospect;
- Zara Central Licence (excluding Koka South);
- Zara North Licence; and
- Zara South Licence.

An overview of the Zara Exploration Areas is included in Section 3 of the CSA Report.

In applying the Appraised Value Method, CSA has determined an appropriate PEM to apply to the relevant and effective past exploration expenditure incurred in each of the areas. Details of the assumptions and valuation method are contained in Section 5 of the CSA Report. CSA's valuation of the Zara Exploration Areas is summarised in the table below:

| ZMSC - Value of the Zara Exploration Areas<br>US$000's | Low | High | Preferred |
|---|---|---|---|
| Koka South prospect | 7,759 | 11,638 | 9,699 |
| Zara Central (excluding Koka South) | 13,238 | 15,886 | 15,886 |
| Zara North | 1,885 | 3,142 | 2,513 |
| Zara South | 1,088 | 2,177 | 1,088 |
| 100% interest | 23,970 | 32,842 | 29,186 |
| Chalice's 60% interest | 14,382 | 19,705 | 17,511 |

Source: CSA Report

Accordingly, CSA valued a 60% interest in the Zara Exploration Areas in a range of US$14.4 million to US$19.7 million, with a preferred value of US$17.5 million.

## 7.3 Valuation Summary

Our valuation of Chalice's 60% participating interest in ZMSC on a net asset backing basis after considering the underlying value of the company's assets and liabilities on a going concern basis is summarised in the table below. Our assessment is primarily based on ZMSC's balance sheet as at 31 March 2012, adjusted for the values assessed for the company's mineral assets, property plant and equipment, cash and other assets and liabilities. Chalice Management confirmed that ZMSC's financial position has not significantly changed subsequent to that date.

In determining the fair value of Chalice's 60% interest in ZMSC's, we adopted the values assessed for Chalice's interest in the Koka Gold Mine (Section 7.1) and the Zara Exploration Areas (Section 7.2), and took 60% of ZMSC's other assets (i.e. cash, trade and other receivables and property, plant and equipment) and shareholder loans as per the company's balance sheet as at 31 March 2012, as summarised in the following table:

| ZMSC - Chalice's 60% interest<br>$000's | Low | High | Midpoint |
|---|---|---|---|
| **Mineral assets:** | | | |
| - Koka Gold Mine | 60,000 | 70,000 | 65,000 |
| - Zara Exploration Areas | 14,382 | 19,705 | 17,511 |
| | 74,382 | 89,705 | 82,511 |
| **Other assets and liabilities:** | | | |
| - Cash and cash equivalents | 707 | 707 | 707 |
| - Trade and other receivables | 1,068 | 1,068 | 1,068 |
| - Property, plant and equipment | 784 | 784 | 784 |
| - Mine development | - | - | - |
| - Shareholder loans - Chalice | (4,788) | (4,788) | (4,788) |
| - Shareholder loans - ENAMCO | (2,394) | (2,394) | (2,394) |
| | (4,624) | (4,624) | (4,624) |
| Fair value of Chalice's 60% interest in ZMSC | 69,758 | 85,081 | 77,887 |

Based on this assessment we have determined the fair value of Chalice's 60% interest of ZMSC to be in the range of between US$69.8 million and US$85.1 million, with a midpoint value of US$77.9 million.

## 7.4 Valuation cross check

To assess the reasonableness of the values assessed for ZMSC we compared the resource and contained gold multiples implied from our valuation with multiples calculated for broadly comparable listed companies with early stage gold projects in Africa. In developing our set of comparable companies, we excluded companies without JORC compliant resources. Since the Koka Gold Mine is still in pre-development stage, we also excluded companies with producing assets. As such, our analysis has focused on companies without any producing assets. The multiples were calculated based on each company's implied trading value per tonne of resource and per oz of contained gold. The implied multiples were calculated as follows:

- obtained the market capitalisation for each company as at 1 May 2012 to calculate an equity value for the company;
- added back net debt or subtracted net cash as reported at the latest available reporting date prior to 1 May 2012, to obtain an enterprise value ("EV") for the company; and
- divided the EV by the number of resource tonnes ("EV/t of resource") and the number of oz of contained gold ("EV/oz of contained gold") to obtain an implied enterprise value on a resource basis. The number of tonnes and number of ounces of contained gold is based on the latest reported resources disclosed by the company as at 1 May 2012.

It is of note that market prices usually reflect the prices paid for small parcels of shares representing minority interests and as such do not include a control premium relevant to a significant parcel of shares. It is generally accepted that in order to acquire a 100% controlling interest in a company, the acquirer must pay a premium over and above the prices at which the shares in the target are trading at prior to the announcement of the takeover bid. Takeover transactions in Australia are typically completed with an implied premium to the pre-bid trading price in the order of 20% to 40%. As a result, we have applied a control premium of 30% to the market capitalisation when determining the EV of each of the comparable companies.

A summary of the implied trading multiples on a per tonne of resource basis and on a per oz of contained gold basis is included below. A summary description of the comparable companies is contained in Appendix C.

| | US$ per M+I resource tonne | US$ per resource tonne | US$ per M+I contained gold oz | US$ per total contained gold oz | Average grade (g/t) |
|---|---|---|---|---|---|
| Cassidy Gold Corp. | 1.0 | 0.9 | 14.4 | 12.3 | 2.2 |
| Axmin Inc. | 0.8 | 0.5 | 13.0 | 8.4 | 1.8 |
| Riverstone Resources Inc. | 0.7 | 0.4 | 20.5 | 13.3 | 0.9 |
| Azumah Resources Ltd | 4.1 | 2.4 | 80.4 | 48.7 | 1.5 |
| Orezone Gold Corporation | 2.5 | 1.2 | 88.4 | 38.2 | 0.9 |
| Ampella Mining Limited | 13.6 | 6.6 | 221.7 | 108.6 | 1.9 |
| PMI Gold Corporation | 6.3 | 4.5 | 79.8 | 56.7 | 2.4 |
| Gryphon Minerals Ltd. | N/A | 11.3 | N/A | 164.1 | 2.1 |
| Low | 0.7 | 0.4 | 13.0 | 8.4 | 0.9 |
| Mean | 4.2 | 3.5 | 74.0 | 56.3 | 1.7 |
| Median | 2.5 | 1.8 | 79.8 | 43.5 | 1.9 |
| High | 13.6 | 11.3 | 221.7 | 164.1 | 2.4 |

Source: Annual reports, ASX announcements and CapitalIQ

The analysis of EV/t of resource shows the trading multiples of gold exploration companies with projects at a stage of development not dissimilar to the Koka Gold Mine have a median of US$1.8/t and average of US$3.5/t, with a range of US$0.4/t to US$11.3/t. The EV/oz of contained gold shows a median of US$43.5/oz and an average of US$56.3/oz, with a range of US$8.4/oz to US$164.1/oz.

We note that there have been no significant changes to the trading multiples from 1 May 2012 to the date of this report.

The mix of classification of measured and indicated resources for each of the comparable companies is shown in the table below. Those resources not in measured and indicated are in inferred. Chalice is included in the list for comparative purposes, with all resources being held within the Koka Gold Mine.

| | Total resources (Mt) | Reserves as a % of resources | M + Ind as a % of total resources | M + Ind contained gold as a % of total resources | Average Grade | Stage of most advanced Project |
|---|---|---|---|---|---|---|
| Cassidy Gold Corp. | 10.2 | 0% | 89% | 86% | 2.2 | Scoping study |
| Axmin Inc. | 53.2 | 44% | 59% | 65% | 1.8 | Feasibility study |
| Riverstone Resources Inc. | 91.4 | 0% | 59% | 65% | 0.9 | Less than a scoping study |
| Azumah Resources Ltd | 34.5 | 0% | 57% | 61% | 1.5 | Feasibility study |
| Orezone Gold Corporation | 128.1 | 0% | 46% | 43% | 0.9 | PFS, with DFS by the end of 2012 |
| Ampella Mining Limited | 42.6 | 0% | 49% | 49% | 1.9 | PFS, DFS to commence in 2012 |
| PMI Gold Corporation | 61.7 | 49% | 70% | 71% | 2.4 | PFS |
| Gryphon Minerals Ltd. | 29.0 | 0% | 0% | 0% | 2.1 | DFS in progress |
| Chalice Gold Mines Ltd. | 5.0 | 86% | 100% | 100% | 5.3 | DFS |
| Low | 5.0 | 0% | 0% | 0% | 0.9 | |
| Mean | 50.6 | 20% | 59% | 60% | 2.1 | |
| Median | 42.6 | 0% | 59% | 65% | 1.9 | |
| High | 128.1 | 86% | 100% | 100% | 5.3 | |

Source: Annual Reports, ASX announcements and CapitalIQ

In assessing the relevant multiples for ZMSC, we determined an EV by adding back to the assessed 100% value the amounts owing to Chalice and ENAMCO less the balance of cash at 31 March 2012. The implied resource multiples for ZMSC are shown in the following table:

**ZMSC - Implied Resource Multiples**

| | Low | High | Midpoint |
|---|---|---|---|
| EV / t resource multiple ($) | 27.8 | 32.8 | 30.5 |
| EV / oz contained gold ($) | 165.5 | 195.2 | 181.3 |

Source: EY analysis

The resource multiples for ZMSC range from US$27.8/t to US$32.8/t compared to the resource multiples of comparable companies that range from US$0.4/t to US$11.3/t with a median of US$1.8/t and average of US$3.5/t.

On a contained ounce of gold basis, the implied multiples for ZMSC range from US$165.5/oz to US$195.2/oz compared to the resource multiples of comparable companies that range from US$8.40/oz to US$164.1/oz with a median of US$43.5/oz and an average of US$56.3/oz.

We note that on a EV/t of resource basis and on an EV/oz of contained gold basis, the implied multiples for ZMSC are higher than those calculated for comparable companies. We note the following possible explanations for this:

- ZMSC has a significantly higher grade than the comparable companies being 5.3g/t compared to a median and average of 1.8g/t and 1.7g/t respectively, with the next highest being a company having an average grade of 2.4g/t.
- The majority of the projects of the comparable companies are at a less advanced stage compared to the Koka Gold Mine, with only one other company completing a DFS on their most advanced project.
- The multiples do not include adjustments for the differences in operations such as the proximity to infrastructure, tax regimes, the timing of the commencement of operations and the capital and operating costs.
- The market capitalisations of the comparable companies have decreased over the time period between the announcement of the Proposed Transaction and the date of this report. Nothing has come to our attention that would indicate the fair value of ZMSC would have decreased from the date of the Proposed Transaction and the date of this report.

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# 8. Evaluation of the Proposed Transaction

## 8.1 Approach

In forming our opinion as to whether the Proposed Transaction is fair and reasonable we have considered:

- whether the value of the Cash Consideration is fair in comparison to the value of 60% interest in ZMSC together with the value of the Chalice Shareholder Loan being sold by Chalice under the Proposed Transaction;
- whether the Cash Consideration includes a premium for control;
- the advantages and disadvantages relevant to Chalice Shareholders; and
- alternatives to the Proposed Transaction.

## 8.2 Valuation conclusion

In determining whether the Proposed Transaction is fair and reasonable to Chalice Shareholders we have compared the value assessed for Chalice's 60% interest in ZMSC and the Chalice Shareholder Loan with the Cash Consideration being offered by SFECO.

The comparison of values, based on the values assessed in Section 7.3, is summarised in the following table:

| Comparison of Values US$000's | Low | High | Midpoint |
|---|---|---|---|
| Fair value of ZMSC - Chalice's 60% interest | 69,758 | 85,081 | 77,887 |
| Add: Loans payable to Chalice | 7,981 | 7,981 | 7,981 |
| Fair value of assets being sold | 77,739 | 93,062 | 85,868 |
| Cash Consideration for Chalice's 60% interest in ZMSC | 78,000 | 78,000 | 78,000 |
| Deferred cash consideration | 1,487 | 1,543 | 1,515 |
| Reimbursement for exploration costs incurred by Chalice | 700 | 700 | 700 |
| Total Cash Consideration | 80,187 | 80,243 | 80,215 |
| Premium / (discount) of Cash Consideration over the value of assets being sold | 2,448 | (12,819) | (5,653) |
| % Premium / (discount) | 3.1% | -13.8% | -6.6% |

Source: EY analysis

Based on this analysis, for the sale of its remaining 60% interest in ZMSC and the Chalice Shareholder Loan under the Proposed Transaction, Chalice is receiving a premium of 3.1% at the low end of our valuation range, a discount of 13.8% at the high end, and a discount at the midpoint of 6.6%. On this basis, approximately 82% of our valuation range for the 60% interest in ZMSC and the Chalice Shareholder Loan is at a discount to the Cash Consideration being paid by SFECO, with approximately 18% being at a premium. Given this weighting, in our opinion, the Proposed Transaction is not fair to Chalice Shareholders.

## 8.3 Commercial and qualitative factors

As part of assessing the Proposed Transaction we also considered the potential advantages and disadvantages to the Chalice Shareholders of the Proposed Transaction and considered whether the advantages outweigh the disadvantages. In doing this we have considered the commercial and qualitative factors relating to the proposed disposal of the Company's 60% interest in ZMSC, which incorporates the Zara Project, and the Chalice Shareholder Loan.

The factors considered are summarized below. We note that individual Chalice Shareholders may interpret these factors differently depending on their individual circumstances.

### 8.3.1 Advantages

**Opportunity to realise investment in ZMSC**

The analysis in Section 8.2 shows that under the Proposed Transaction, SFECO is paying a premium on the low end of our assessed value of Chalice's 60% interest in ZSMC and the Chalice Shareholder Loan and a discount at the high end of our valuation range. The payment of a premium is to the benefit of Chalice Shareholders, whereas a discount is to the detriment of Chalice Shareholders.

While the Proposed Transaction appears to be finely priced, the sale of the 60% interest in ZMSC and the Chalice Shareholder Loans does allow Chalice to exit the Zara Project at a significant cash premium to what the Company has spent. The acceptance of the Proposed Transaction also provides some certainty. Ongoing involvement in the Zara Project would continue to expose Chalice to the risks of developing and operating a gold project in Eritrea.

If Chalice Shareholders do not approve the Proposed Transaction and there is no superior alternative offer for the 60% interest in ZMSC and the Chalice Shareholder Loan, the premium implied by the offer from SFECO would be lost.

**Cash available for development of remaining assets and/or acquisition opportunities**

Upon completion of the Proposed Transaction and the transaction with ENAMCO, Chalice has estimated it will have cash in the bank of approximately $84 million or cash backing of $0.34 per share.

We have been advised that Chalice will potentially look to invest in a developed or developing project, and, subject to drilling results, continue to explore its Mogoraib North and Hurum exploration projects.

**Potential dilution in ownership**

Due to the estimated US$122 million required to fund capital expenditure, of which Chalice is required to contribute two thirds of this funding, Chalice will be required to raise a significant amount of funds. While part of the funding could be raised through debt, there is a possibility that Chalice would have to raise a portion of that through equity. With a market capitalisation of approximately $75 million on 23 December 2011 and a share price at that time of $0.30 (down to $0.23 on 9 May 2012) it is likely that any future equity raising would be dilutive to existing shareholders.

### 8.3.2 Disadvantages

**No participation in the future growth of the ZMSC's mineral assets**

By accepting the Proposed Transaction, Chalice's assets will be comprised of cash and its 60% interest in the Mogoraib North and Hurum exploration projects. This assumes that the amount owing by ENAMCO for the purchase of the 30% interest in ZMSC is paid. With Chalice no longer having an interest in ZMSC, Chalice Shareholders would be giving up the right to participate in the future upside, if any, associated with the Koka Gold Mine and the Zara Exploration Areas.

**One-off transaction costs**

Chalice management has estimated that incremental costs associated with the Proposed Transaction will be approximately $350,000. These costs include advisory fees, costs for the preparation of the Notice of Meeting and Explanatory Statement, professional fees and costs associated with the dispatch of documents. We understand that these costs will be borne by Chalice regardless of whether the Proposed Transaction is or is not approved.

### 8.3.3 Pro-forma financial position

Chalice has prepared its pro-forma balance sheet based on its consolidated unaudited balance sheet as at 31 March 2012, with adjustments for the following items:

- the de-consolidation of ZMSC, which is currently consolidated in Chalice's accounts on a 100% basis;
- the initial Cash Consideration to be received from the Proposed Transaction on settlement;
- the cash to be received from ENAMCO for the purchase of a 30% interest in ZMSC;
- the estimated taxes payable on the proceeds to be received for the ENAMCO transaction and the Proposed Transaction; and
- the payment of $1.5 million to Dragon Mining to settle the trailing payment of $4 million payable to Dragon Mining in the event that a 1 million oz ore reserve is delineated within the Zara Project.

We present Chalice's pro-forma balance, based on the forecast position subsequent to the Proposed Transaction on a stand lone basis and then with the completion of the ENAMCO transaction and the payment to Dragon Mining of $1.5 million.

| Chalice - Pro-forma Balance Sheet A$000's | Chalice 31Mar12 | Post Proposed Transaction | Chalice Pro-forma |
|---|---|---|---|
| **Current assets** | | | |
| Cash and cash equivalents | 4,750 | 62,571 | 83,911 |
| Trade and other receivables | 1,941 | 223 | 223 |
| | 6,691 | 62,794 | 84,134 |
| **Non-current assets** | | | |
| Financial assets | 870 | 870 | 870 |
| Property, plant and equipment | 31,961 | 306 | 306 |
| Exploration and evaluation expenditure | 15,487 | 2,687 | 2,687 |
| | 48,318 | 3,863 | 3,863 |
| Total assets | 55,009 | 66,657 | 87,997 |
| **Current liabilities** | | | |
| Trade and other payables | 1,536 | 133 | 133 |
| Employee benefits | 81 | 81 | 81 |
| Unearned income | 2,895 | 2,895 | - |
| | 4,512 | 3,109 | 214 |
| **Non-current liabilities** | | | |
| Loans and borrowings | 3,852 | 0 | 0 |
| Provisions | 48 | 48 | 48 |
| | 3,900 | 48 | 48 |
| Total liabilities | 8,412 | 3,158 | 263 |
| **Net assets** | **46,597** | **63,499** | **87,734** |

Source: Chalice's and ZMSC's unaudited balance sheets as at 31 March 2012 and EY analysis

The 'Post Proposed Transaction' column represents the de-consolidation of ZMSC from Chalice's accounts, the receipt of the initial Cash Consideration of US$78 million and the taxes expected to be paid thereon.

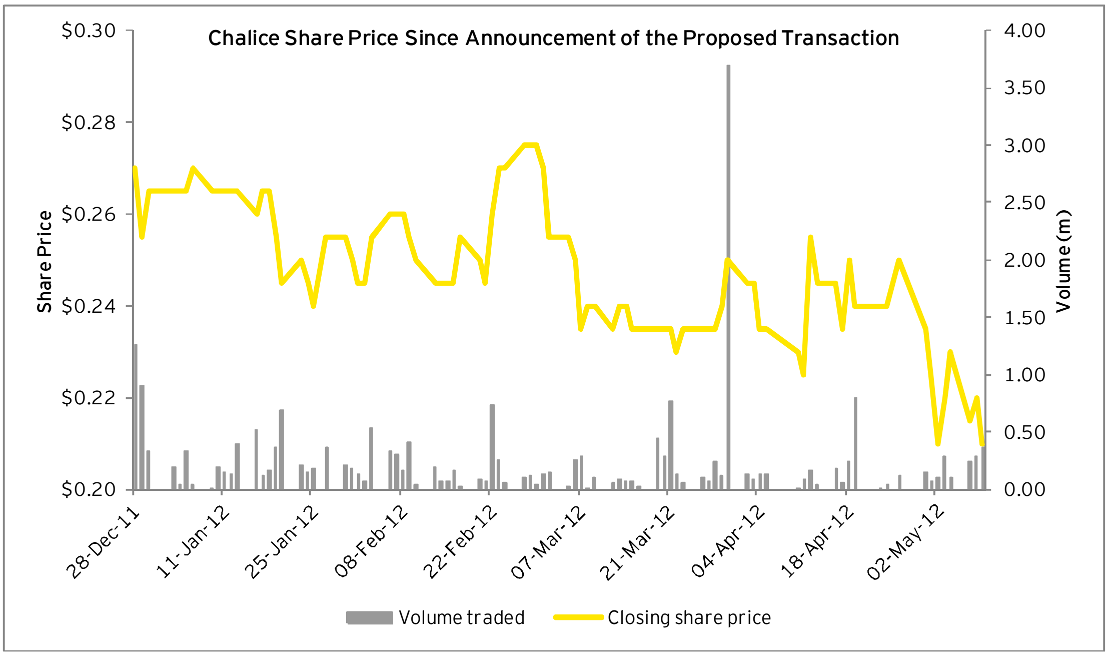
The 'Chalice Pro-forma' column includes the pro-forma values for the Proposed Transaction, the receipt of funds from the ENAMCO transaction, the taxes expected to be paid thereon and the payment to Dragon of $1.5 million.

As mentioned previously, subsequent to the completion of the Proposed Transaction and the transaction with ENAMCO, Chalice is expected to have cash on hand totalling approximately $84 million and capitalised costs associated with its remaining exploration projects. This represents a cash backing per share of $0.34, compared to the current cash position of $0.02 per share.

## 8.4 Other factors

### 8.4.1 Market reaction post the announcement of the Proposed Transaction

The last trading price of Chalice's shares on the ASX on 23 December 2011, being the last trading day prior to the announcement of the Proposed Transaction, was $0.30. Based on the daily closing price of the Company's shares, the following chart illustrates the prices and volumes at which Chalice's shares traded over the period 28 December 2011 and 9 May 2012.




Source: Capital IQ, EY analysis

On coming out of the trading halt post the announcement of the Proposed Transaction on 28 December 2011, Chalice's shares traded up to $0.32 before closing on that day at $0.27. Since then Chalice's share price has traded in the range of between $0.210 and $0.285, closing on 9 May 2012 at $0.210. This trading range is slightly lower than the prices at which Chalice's shares were being brought and sold in the period leading up to the announcement of the Proposed Transaction. Daily trading volumes in the period post the announcement to 9 May 2012 were slightly below the Company's historical trading volumes. We note that the spike in shares traded on 30 March 2012 represents a trading volume of 1.4% of the shares outstanding, with the average percentage of shares trading on a daily basis being 1.00% since the announcement of the Proposed Transaction.

Based on this analysis the market appears to be indifferent to the Proposed Transaction.

### 8.4.2 The ENAMCO Transaction

To assess the reasonableness of our fair value conclusion for Chalice's 60% interest in ZMSC, we compared our assessed fair value with the consideration agreed upon between Chalice and ENAMCO for a 30% interest in ZMSC that was entered into during July 2011. Under the agreement between Chalice and ENAMCO, the fair value of a 30% interest in ZMSC was deemed to be US$32 million plus an additional amount of US$3 million. This would imply a fair value of a 60% interest in ZMSC of US$70 million. Our assessed fair value of a 60% interest in ZMSC is in the range of US$70 million to US$85 million.

### 8.4.3 Tax implications

According to calculations provided by Chalice Management, we note that as a result of the Proposed Transaction, Chalice is expected to incur taxes payable to the Eritrean Government. Based on a Cash Consideration of US$78 million, being the initial amount to be received on settlement, the taxes payable on the Proposed Transaction are estimated to be US$17.0 million.

### 8.4.4 Directors' view

We note that the Directors of Chalice have unanimously recommended the Proposed Transaction to Chalice Shareholders in the absence of a superior proposal. The support of the Directors should provide additional comfort to Chalice Shareholders.

### 8.4.5 No alternative offers

We have discussed with the Directors of Chalice the likelihood of alternative offers emerging. The Directors of Chalice have advised that they have not received an alternative or superior offer for the 60% interest in ZMSC and the Chalice Shareholder Loan as at the date of this report.

### 8.4.6 Other considerations

This independent expert's report only provides general information. It does not take into account a shareholder's individual situation, objectives and needs. It is not intended to replace professional advice obtained by Chalice Shareholders. Chalice Shareholders should consider whether this report is appropriate for their circumstances, having regard to their own situation, objectives and needs before relying on or taking action based on this report. Chalice Shareholders should seek their own professional advice.

This report has been prepared to assist Chalice's Shareholders in assessing the merits of the Proposed Transaction.

Whether individual shareholders should vote to accept or not accept the Proposed Transaction depends upon their individual situation, objectives and needs, as well as each shareholder's views as to the reasonableness factors associated with either accepting or not accepting the Proposed Transaction.

## 8.5 Conclusion on the Proposed Transaction

Based on the analysis conducted throughout this report, which indicated that SFECO is offering a premium at the low end of the fair value of Chalice's 60% interest in ZMSC and the Chalice Shareholder Loan, a discount at the high end and at the midpoint, in our opinion, the Proposed Transaction is not fair to Chalice Shareholders.

In Section 8.3, we set out the commercial and qualitative factors relevant to the consideration of the Proposed Transaction and in Section 8.4 we considered other factors relevant to the Proposed Transaction. While individual shareholders may interpret these factors differently depending on their own individual circumstances, in Ernst & Young Transaction Advisory Services' opinion the potential advantages outweigh the potential disadvantages to the shareholders as a whole.

Based on the results of the analysis undertaken, in our opinion, the Proposed Transaction is not fair but reasonable to Chalice Shareholders.

Having regard to the nature of the Proposed Transaction and the advantages and disadvantages, it is the opinion of Ernst & Young Transaction Advisory Services, that Chalice Shareholders are likely to be better off if the Proposed Transaction proceeds.

# Appendix A Statement of qualifications and declarations

Ernst & Young Transaction Advisory Services, which is wholly owned by Ernst & Young, holds an Australian Financial Services Licence under the Corporations Act and its representatives are qualified to provide this report. The directors of Ernst & Young Transaction Advisory Services responsible for this report have not provided financial advice to Chalice.

Prior to accepting this engagement, Ernst & Young Transaction Advisory Services considered its independence with respect to Chalice with reference to Regulatory Guide 112, *Independence of experts*.

This report has been prepared specifically for the Shareholders of Chalice in relation to the Proposed Transaction. Neither Ernst & Young Transaction Advisory Services, Ernst & Young and any employee thereof undertakes responsibility to any person, other than the Chalice Shareholders, in respect of this report, including any errors or omissions howsoever caused.

The statements and opinions given in this report are given in good faith and the belief that such statements and opinions are not false or misleading. In the preparation of this report Ernst & Young Transaction Advisory Services has relied upon and considered information believed after due inquiry to be reliable and accurate. Ernst & Young Transaction Advisory Services has no reason to believe that any information supplied to it was false or that any material information has been withheld from it. Ernst & Young Transaction Advisory Services has evaluated the information provided to it by Chalice, its advisors, as well as other parties, through inquiry, analysis and review, and nothing has come to its attention to indicate the information provided was materially mis-stated or would not afford reasonable grounds upon which to base its report. Ernst & Young Transaction Advisory Services does not imply and it should not be construed that it has audited or in any way verified any of the information provided to it, or that its inquiries could have verified any matter which a more extensive examination might disclose.

The information relied upon in the preparation of this report is set out in Appendix D to this report.

Chalice has provided an indemnity to Ernst & Young Transaction Advisory Services for any claims arising out of any mis-statement or omission in any material or information provided to it in the preparation of this report.

Ernst & Young Transaction Advisory Services provided draft copies of this report to the directors and management of Chalice for their comments as to factual accuracy, as opposed to opinions, which are the responsibility of Ernst & Young Transaction Advisory Services alone. Changes made to this report as a result of this review by the directors and management have not changed the methodology or conclusions reached by Ernst & Young Transaction Advisory Services.

Ernst & Young Transaction Advisory Services will receive a professional fee based on time spent in the preparation of this report estimated at approximately $75,000 (exclusive of GST). Ernst & Young Transaction Advisory Services will not be entitled to any other pecuniary or other benefit whether direct or indirect, in connection with the making of this report.

Mr Ken Pendergast, a director and representative of Ernst & Young Transaction Advisory Services and a partner of Ernst & Young and Ms Brenda Moore, an authorised representative of Ernst & Young Transaction Advisory Services and an Executive Director of Ernst & Young have assumed overall responsibility for this report. Both have the necessary experience and professional qualifications appropriate to the advice being offered. Other Ernst & Young Transaction Advisory Services staff have been consulted in the preparation of this report where appropriate.

It is not intended that the report should be used for any other purpose other than to be included in the Notice of Meeting and Explanatory Statement to be sent to Chalice shareholders with respect to the Proposed Transaction. In particular, it is not intended that this report should be used for any other purpose other than as an expression of its opinion as to whether or not the Proposed Transaction is in the best interests of Chalice Shareholders.

Ernst & Young Transaction Advisory Services consents to the issue of this report in the form and context in which it is included in the Notice of Meeting and Explanatory Statement.

# Appendix B Determination of discount rates

**Introduction**

Our valuation of the Koka Gold Mine is based on US$ denominated forecast cash flows that have been prepared on a real, ungeared and post-tax basis. To determine the net present value of these cash flows we have assessed the appropriate discount rate on a real, post-tax weighted average cost of capital ("WACC") basis. The WACC represents the average of the rates of return required by providers of debt and equity capital to compensate for the time value of money and the perceived risk or uncertainty of the cash flows, weighted in proportion to the market value of the debt and equity capital provided.

Under a classical tax system the post tax WACC is commonly calculated as follows:

$$WACC = R_e x \frac{E}{D+E} + R_d (1 - t_c) x \frac{D}{D+E}$$

Where:

*WACC* - post tax weighted average cost of capital

$R_e$ - required rate of return on equity capital

*E* - market value of equity capital

*D* - market value of debt

$R_d$ - required rate of return on debt capital

$t_c$ - statutory corporate tax rate

In the following paragraphs we comment on each of the assumptions we make in respect of each of the main variables in this formula.

**Required rate of return on equity**

The capital asset pricing model ("CAPM") is a model for estimating the rate of return required by an equity investor on an investment.

Under CAPM the required rate of return on equity ($R_e$) is calculated as follows:

$$R_e = R_f + \beta_e \, x \, (R_m - R_f) + R_s$$

Where:

$R_e$ - rate of return on equity

$R_f$ - risk free rate of return

$\beta_e$ - expected equity beta of the investment

$R_m$ - expected rate of return on the market portfolio of risky investments

($R_m$- $R_f$) - excess return of the market over the risk free rate, or the market risk premium

$R_s$ - specific risk premium

### Risk free rate

In the absence of an official risk free rate, most valuation practitioners adopt the yield on Government Bonds (in the appropriate jurisdiction) of a term matching the cash flow forecast period as a proxy. Typically for global markets the 10-year US Government Bond rate is used as a proxy for the risk free rate.

Our selected risk free rate is based on the yield on 10-year US Government Bonds as at 1 May 2012. On this basis we have adopted a nominal risk free rate of 1.96% for the purposes of determining an appropriate cost of equity.

### Market risk premium

The market risk premium represents the additional return an investor expects to receive to compensate for additional risk associated with investing in equities as opposed to assets on which a risk free rate of return is earned. Our assessment of the expected return of the market over the risk free rate is based on various studies based on historic returns over the short term and long term, forward-looking premium estimates, recent published views, academic studies and current market research. These sources generated a range of indications of market risk premium. However, our consideration of the data led us to the conclusion that 7.0% represented a consensus of reasonable viewpoints of a market risk premium, and for the purpose of this report we have adopted a market risk premium of 7.0%.

### Beta

The beta measures the expected relative risk of the equity in a company. The choice of the beta requires judgement and necessarily involves subjective assessment as it is subject to measurement issues and a high degree of variation. In order to determine an appropriate beta to use for the valuation of the Koka Gold Mine, we have considered the observed betas of comparable companies with similar assets.

Beta can be expressed as an equity beta, which includes the effect of gearing on equity returns, and as an asset beta, which removes the impact of gearing. The asset beta will be lower than the equity beta for any given investment, with the extent of the difference dependent on the level of debt in the capital structure. The greater the level of gearing, the greater is the risk faced by equity holders (as debt holders have a contractual right of return and so first claim on the operating income). Accordingly, for a given asset beta, the equity beta will increase as the level of gearing increases.

We used the following formula to undertake the de-gearing and re-gearing exercise:

$$\beta_e = \beta_a\left(1 + \frac{D}{E}(1 - t_c)\right)$$

Where:

$\beta_e$ – the equity or geared beta

$\beta_a$ – the ungeared beta

$t_c$ – the statutory corporate tax rate

*D/E* – equals the market value of debt divided by the market value of equity capital

Our analysis of the un-geared betas for gold development companies with operations in Africa is set out in the tables below.

**Beta analysis – companies with producing assets**

| Comparable Company | Country | Observed Equity Beta[1] | Market Capitalisation[2] | Net Debt/ Equity[3] | Asset Beta[4] |
|---|---|---|---|---|---|
| Nevsun Resources Ltd. | Canada | 1.07 | 731.72 | -11.0% | 1.07 |
| Banro Corporation | Canada | 1.70 | 840.10 | -9.1% | 1.70 |
| Perseus Mining Ltd. | Australia | 1.06 | 1199.86 | -16.7% | 1.06 |
| Avion Gold Corporation | Canada | 1.18 | 438.15 | 28.6% | 0.98 |
| Avocet Mining plc | United Kingdon | 0.95 | 339.66 | -6.1% | 0.95 |
| Resolute Mining Ltd. | Australia | 1.04 | 1108.78 | 25.3% | 0.88 |
| Golden Star Resources, Ltd. | United States | 1.45 | 395.81 | 10.6% | 1.36 |
| Endeavour Mining Corporation | Cayman Island | 0.75 | 502.34 | -41.6% | 0.75 |
| Cluff Gold plc | United Kingdon | 1.07 | 135.85 | -6.3% | 1.07 |
| **Low** | | **0.75** | | **-41.6%** | **0.75** |
| **Simple Average** | | **1.14** | | **-2.9%** | **1.09** |
| **Median** | | **1.07** | | **-6.3%** | **1.06** |
| **Weighted Average** | | **1.15** | | **-2.6%** | **1.10** |
| **High** | | **1.70** | | **28.6%** | **1.70** |

Source: Capital IQ, EY analysis

**Beta analysis – companies with exploration assets or assets in development**

| Comparable Company | Country | Observed Equity Beta[1] | Market Capitalisation[2] | Net Debt/ Equity[3] | Asset Beta[4] |
|---|---|---|---|---|---|
| Chalice Gold Mines Ltd. | Australia | 0.46 | 56.25 | -44.7% | 0.46 |
| Keegan Resources Inc. | Canada | 1.24 | 240.85 | -22.6% | 1.24 |
| Gryphon Minerals Ltd. | Australia | 1.42 | 330.85 | -16.4% | 1.42 |
| Ampella Mining Limited | Australia | 0.65 | 253.83 | -29.5% | 0.65 |
| Noble Mineral Resources Ltd. | Australia | 0.71 | 180.34 | -11.7% | 0.71 |
| Orezone Gold Corporation | Canada | 1.06 | 145.56 | -14.0% | 1.06 |
| Volta Resources Inc. | Canada | 1.59 | 130.51 | -10.4% | 1.59 |
| Azumah Resources Ltd | Australia | 1.24 | 80.06 | -13.1% | 1.24 |
| PMI Gold Corporation | Canada | 2.18 | 242.28 | -1.2% | 2.18 |
| Pelangio Exploration Inc. | Canada | 0.93 | 56.40 | -7.7% | 0.93 |
| **Low** | | **0.46** | | **-44.7%** | **0.46** |
| **Simple Average** | | **1.15** | | **-17.1%** | **1.15** |
| **Median** | | **1.15** | | **-13.5%** | **1.15** |
| **Weighted Average** | | **1.24** | | **-16.4%** | **1.24** |
| **High** | | **2.18** | | **-1.2%** | **2.18** |

Source: Capital IQ, EY analysis

Notes

1. Raw beta calculated over a 2 year period with monthly observations except where otherwise stated.
2. Market Capitalisation at last reporting period in currencies of the local exchange.
3. Net debt is total debt less cash and cash equivalents over a four year historic period (where available). Equity value is at the valuation date.
4. Where the Net Debt/Equity ratio is negative the ungeared Beta has been taken to equal the Geared Beta

We have adopted an asset beta for the Koka Gold Mine in the range of 1.10 to 1.25. In selecting this beta range, we have considered the following:

- The average and median asset betas of companies with producing assets comparable to the Koka Gold Mine are 1.14 and 1.07, respectively.
- The average and median asset betas of companies with exploration assets or assets in development comparable to the Koka Gold Mine are 1.15 and 1.15, respectively.
- Nevsun the company that has a majority interest in the Bisha Gold Mine which is in close proximity to Koka has an asset beta of 1.07.

### Capital structure

In calculating the WACC, we need to determine an optimal capital structure at which to re-gear the asset beta, and with which to weight the cost of equity and cost of debt. Generally, the gearing level adopted should reflect the level of debt that can reasonably be sustained by any company operating in an industry, rather than actual gearing maintained by the current business owners.

In order to determine an appropriate capital structure for the Koka Gold Mine, we have had regard to both Chalice's capital structures, and the capital structure of other companies in the industry. In relation to the capital structure, we note that Chalice's average debt to equity ratio over the last four years was consistently below zero, implying a net cash position. The average debt to equity ratio of comparable companies over the past four years was also negative.

Despite being in a negative net debt position, for those companies with producing assets, the majority held some debt at the valuation debt. Accordingly, we have assumed that the Koka Gold Mine would be fully funded from both debt and equity and have adopted a gearing ratio of 15% for these assets.

### Specific risk premium

Specific risk premium represent the additional return an investor expects to receive to compensate for country, size and project related risks not reflected in the beta of the comparable companies analysed.

In assessing an appropriate premium to be applied, we have considered the following factors:

- The ongoing economic and political risks of operating in Eritrea, which continues to be subject to certain UN sanctions.
- Liquidity and yields of publicly traded government bonds with similar ratings.
- Size of comparable companies relative to size of Chalice's operations.

With respect to country risk we considered data from Damodaran, which while did not specifically deal with Eritrea did contain reference to appropriate risk premiums for other African countries. After considered this information and the matters listed above we have applied a specific risk premium in the range of 7.0% to 8.0% for the Koka Gold Mine.

### Cost of debt

Our selected cost of debt is based on the yield on BBB-rated bond yield as at 1 May 2012. On this basis we have adopted an additional premium of 1.78% for the purposes of determining an appropriate cost of debt.

## WACC

On the basis of the above, we have adopted the following inputs in our calculation of a range of real, post-tax WACC:

### WACC calculation for the Koka Gold Mine

| Parameter | Low WACC | High WACC | Source |
|---|---|---|---|
| Risk Free Rate ($R_f$) | 1.96% | 1.96% | 10 Year US Government bond |
| Market Risk Premium ($R_m$-$R_f$) | 7.0% | 7.0% | Industry Standard |
| Specific Risk Premium (Rs) | 7.0% | 8.0% | Individual Assessment |
| Asset Beta ($\beta_a$) | 1.10 | 1.25 | Comparative Analysis |
| Equity Beta ($\beta_e$) | 1.22 | 1.39 | $= \beta_a*(1+((D / E)*(1-t_c)))$ |
| Debt Premium | 1.78% | 1.78% | Market Analysis |
| Nominal Pre-Tax Cost of Debt ($R_d$) | 3.74% | 3.74% | 7 Year US Corporate Bond |
| Tax Rate ($t_c$) | 38.0% | 38.0% | Legislation |
| Debt Equity (D / E) | 17.6% | 17.6% | = (D / V) / (E / V) |
| Debt Proportion (D / V) | 15.0% | 15.0% | Company and Comparative Analysis |
| Equity Proportion (E / V) | 85.0% | 85.0% | Company and Comparative Analysis |

| Parameter | Low WACC | High WACC | |
|---|---|---|---|
| Cost of Equity ($R_e$) | 17.5% | 19.7% | $= R_f + \beta_e \times (R_m-R_f) + R_s$ |
| Nominal Post Tax WACC ($R_w$) | 15.2% | 17.1% | $= (E / V) \times R_e + (D / V) \times (1 - t_c) \times R_d$ |
| Inflation estimate ($\pi$) | 2.0% | 2.0% | Consensus forecasts |
| Real Post Tax WACC ($R_r$) | 13.0% | 14.8% | $= (1+R_w) / (1+\pi) - 1$ |
| **Say,** | **13.0%** | **15.0%** | |

Source: EY Analysis

Based on the above analysis, we have assessed the following real, post-tax discount rates to apply in the discounted cash flow valuation of the Koka Gold Mine in the range of 13.0% to 15.0%.

# Appendix C Description of comparable companies

**Cassidy Gold Corp.**
Cassidy Gold Corp. ("Cassidy") is a gold exploration and development company with its principle asset being the Kouroussa Gold Project, which contains 1.04 million oz of indicated and inferred gold resource. The project is located 570km east of the capital Conakry, in the heart of the highlands of Guinea, on seven permit areas totalling 933km2. Cassidy has completed a scoping study for the Kouroussa Gold Project based on an average of 79,000 oz of gold annually at a cash operating cost of US$484/oz over a 6-year mine life. Cassidy also has other assets being the Nassile Project located 100km southwest of Niamey the capital of Niger. Cassidy is listed on the TSX Venture Exchange.

**Axmin Inc.**
Axmin Inc. ("Axmin") is a gold exploration and development company with its principle asset being the Passendro Gold Project, which contains 1.45 million oz of proven and probable gold reserve. The project is located 60km north of town of Bambari and covers 90km of strike along the Bambari greenstone belt. Axmin has completed a Feasibility Study in 2011 with a mine throughput of 2.8 Mtpa at a cash operating cost of US$484/oz over a mine life of 8.3 years. Axmin has a mandate letter with the Standard Bank of South Africa to arrange and underwrite up to US$100 million of debt financing for Passendro. Axmin also has exploration assets in Mali, Senegal and Mozambique. Axmin is listed on the TSX Venture Exchange.

**Riverstone Resources Inc.**
Riverstone Resources Inc. ("Riverstone") is a gold exploration and development company with extensive interests in Burkina Faso, West Africa. Riverstone's principle asset is the Karma Project, which contains 2.7 million oz of indicated and inferred gold resource. The project has five contiguous permits located 100km northwest of Ouagadougou. Riverstone also has other projects being the Ligidi Project and the Bissa Project. Riverstone is listed on the TSX Venture Exchange.

**Azumah Resources Limited**
Azumah Resources Limited ("Azumah") is a gold exploration and development company with its principle asset being the Wa Gold Project in northwest Ghana, West Africa. The project covers a total land holding of 3,157km2, including over 100km of strike of prospective Birimian greenstone belt and contains 1.16 million oz of indicated and inferred gold resource across three key deposits being Kunche, Bepkong and Julie. Feasibility study for the project is due for completion in early 2012. Azumah is listed on the ASX and the Toronto Stock Exchange.

**Orezone Gold Corporation**
Orezone Gold Corporation ("Orezone") is a gold exploration and development company with extensive interests in Burkina Faso, West Africa. Orezone's key assets are Bombore and Bondi, which contains in total of 3.9 million oz of measured, indicated and inferred gold resource. The Bombore Project is the largest undeveloped gold deposit in Burkina Faso with an area of 168km2 and it is located 85km east of Ouagadougou. Orezone has undertaken a preliminary economic assessment in 2011 and a full feasibility study for the project is due for completion in Q3 2012. The Bondi Project is located on the Houndé Greenstone Belt in the southwest of Burkina Faso covering an area of 224km2. Orezone has recently signed a definitive agreement with Cluff Gold plc for the sale and transfer of the Sega Project. The Sega Project is located 150km northwest of the Burkina Faso capital of Ouagadougou. Orezone also has Uranium interest in Niger through its 67% owned Brighton Energy subsidiary located in the Tim Mersoï Basin in the Republic of Niger, West Africa. Orezone is listed on the Toronto Stock Exchange.

**Ampella Mining Limited**
Ampella Mining Limited ("Ampella") is a gold exploration and development company with interests in Burkina Faso, West Africa. Ampella's key asset is the Batie West Project, which contains five contiguous tenements being Danhal, Gbingbina, Mabera, Tiopolo and Kpere Batie. The Batie West Project covers an area of 811km2 and occupies a 110km long gold-bearing shear zone in southern Burkina Faso. The Konkera prospect, on the Tiopolo licence contains 2.6 million oz of indicated and inferred gold resource. A prefeasibility study for the Konkera prospect is due for completion in Q2 2012. Ampella's other assets are Donko, Doulnia and Madougou. Ampella is listed on the ASX.

**PMI Gold Corporation**
PMI Gold Corporation ("PMI") is a gold exploration and development company with its main project being the Obotan Project. The project is located within the northern 15km of the 70km strike length of contiguous concessions in the Asankrangwa Gold Belt and comprises of four known deposits Nkran, Abore, Adubiaso and Asuadai. The Obotan Project contains 2.26 million oz of proven and probable gold reserve. A pre-feasibility study for the project has been completed and released in January 2012 with an average annual gold production of 205,000 oz over a 11.2 year mine life at a cash cost of US$690/oz. A definitive feasibility study is due for completion in Q2 2012, leading to a development decision in Q3 2012. PMI's other asset is the Kubi Project, located 65km east of the Obotan Gold Project and it is PMI's second proposed 'mining centre' which has advanced exploration and development potential. The project contains 350,000 oz of measured, indicated and inferred gold resource. PMI's also has exploration assets being the Asanko Regional Exploration Project, which is a regionally contiguous group of tenements covering about 55km of strike in the Asankrangwa Gold Belt. PMI is listed on the ASX, the TSX Venture Exchange and the Frankfurt Stock Exchange.

**Gryphon Minerals Ltd.**
Gryphon Minerals Ltd. ("Gryphon") is a gold exploration and development company with its main project being the Banfora Gold Project. The project is located in the south-west of Burkina Faso, West Africa and comprises of five main prospects being Nogbele, Fourkoura, Samavogo, Stinger and Ouahiri. The Banfora Project contains 2 million oz of inferred gold resource. Feasibility study for the project was completed in 2011 for a 2.5 Mtpa operation at a cash cost of US$430/oz. A detailed feasibility study for the project is due for completion. Gryphon also has other assets being Tijirit, Akjoujt and Saboussiri. Gryphon is listed on the ASX.

# Appendix D Sources of information

In preparing this report, Ernst & Young Transaction Advisory Services had regard to the following sources of information:

- Chalice's annual reports for FY09, FY10, FY11 and management accounts for the six months ended 31 December 2011 and nine months ended 31 March 2012;
- Chalice's FY12 Quarterly reports;
- ZMSC balance sheets as at 1Apr11, 31Dec11 and 31Mar12;
- The Heads of Terms between SFECO and Chalice Shareholders;
- The Agreement for Sale and Purchase of shared in ZMSC between Chalice and SFECO dated 29 April 2012;
- Chalice shareholder information, as provided by the Company's share registry;
- final draft Notice of Meeting prepared by Chalice for the Meeting;
- Chalice's DFS and Technical Report for the Koka Gold Mine dated July 2010;
- Chalice' LOM Model for the Koka Gold Mine;
- Management's calculations for the estimation of taxes payable for the Proposed Transaction and ENAMCO Transaction;
- The CSA Report;
- discussions with Chalice management;
- various public disclosure documents lodged by Chalice with the ASX, including public announcements in relation to the Proposed Transaction;
- information from Chalice's website, c*halicegold.com*;
- ASIC Regulatory Guides;
- Reuters;
- Capital IQ;
- IBISWorld;
- Various broker reports for Chalice;
- Thompson Research;
- the Act and the Regulations;
- DatAnalysis; and
- other publicly available information.

# Appendix E Glossary

| Abbreviation | Full Title / Description |
|---|---|
| A$ | Australian dollar |
| ACCC | Australian Competition and Consumer Commission |
| Act | The Corporations Act |
| Ampella | Ampella Mining Limited |
| ASIC | Australian Securities and Investments Commission |
| ASX | Australian Securities Exchange |
| Axmin | Axmin Inc. |
| Azumah | Azumah Resources Limited |
| Break Fee | 1% of the Cash Consideration |
| CAPM | Capital Asset Pricing Model |
| Cassidy | Cassidy Gold Corp. |
| Castle | Castle Minerals Limited |
| Chalice Shareholders | The shareholders of Chalice |
| Chalice, the Company | Chalice Gold Mines Limited |
| CGM(E) | Chalice Gold Mines (Eritrea) Pty Ltd |
| CIS | Commonwealth Independent States |
| CSA | CSA Global Pty Ltd |
| DCF | Discounted cash flow |
| DFS | Definitive feasibility study |
| Dragon Mining | Dragon Mining Ltd |
| EBITDA | Earnings before interest, tax, depreciation and amortisation |
| ENAMCO | Eritrean National Mining Corporation |
| ENAMCO Transaction | An agreement whereby Chalice will sell a 30% interest in ZMSC to ENAMCO for US$32 million plus approximately US$2 million reimbursement of costs |
| Ernst & Young Transaction Advisory Services | Ernst & Young Transaction Advisory Services Limited |
| EU | European Union |
| EV | Enterprise value |
| EV/oz of contained gold | Number of oz of contained gold |
| FSG | Financial Services Guide |
| FYxx | Financial year ended 30 June 20xx |
| GFC | Global Financial Crisis |
| grams/t | Gold per tonne |
| Gryphon | Gryphon Minerals Ltd. |
| Heads of Terms | The conditional agreement with SFECO |
| IPO | Initial Public Offering |
| IRR | Internal Rate of Return |
| JORC Code | Code for Reporting of Mineral Resources and Ore Reserves as prescribed by the Australasian Joint Ore Reserves Committee |
| JV | Joint venture |
| LOM | Life of Mine |
| m | Million |

| Abbreviation | Full Title / Description |
|---|---|
| Meeting | General meeting of the Company that is to be held on or about 27 June 2012 |
| Mineral Resources | Mineral Resources Limited |
| Mt | Million tonnes |
| Mtpa | Million tonnes per annum |
| Nevsun | Nevsun Resources Ltd |
| NPAT | Net profit after tax |
| NPV | Net Present Value |
| Orezone | Orezone Gold Corporation |
| PEM | Prospectivity Enhancement Multiplier |
| PFDJ | Peoples' Front for Democracy and Justice |
| PFS | Pre-feasibility study |
| Phoenix | Phoenix Copper Ltd |
| PMI | PMI Gold Corporation |
| Proposed Transaction | The sale of the Company's remaining 60% interest in ZMSC, the holder of the Zara Project |
| Report | Independent Expert's Report |
| RG 111 | ASIC Regulatory Guide 111: Content of expert reports |
| Riverstone | Riverstone Resources Inc. |
| SFECO | China SFECO Group |
| Shanghai Construction Group | Shanghai Construction Group Co. Ltd |
| SIIC | Shanghai Industrial Investment (Holding) Co. Ltd. |
| Sub-Sahara | Sub-Sahara Resources Limited |
| CSA Report | Independent report prepared by CSA |
| t | Tonnes |
| TSX | Toronto Stock Exchange |
| UN | United Nations |
| US$ | United States dollars |
| WACC | Weighted average cost of capital |
| YTD | Year to date |
| Zara Project | The Zara Project |
| ZMSC | Zara Mining Share Company |
| 1Apr11 | 1 April 2011 |
| 30Junxx | 30 June 20xx |
| 31Dec11 | 31 December 2011 |
| 31Mar12 | 31 March 2012 |

# Appendix F CSA Report

CSA Global Pty Ltd
Level 2, 3 Ord Street
West Perth, WA 6005

PO Box 141
West Perth, WA 6872
Australia

T +61 8 9355 1677
E csaaus@csaglobal.com

ABN 67 077 165 532
www.csaglobal.com

Date: 16 May 2012
Report No: R162.2012

*Independent Technical Report*

**CHALICE GOLD MINES LIMITED**

# Independent Technical Valuation of Mineral Assets

## Zara Gold Project

**Eritrea**

**By**
**Paddy Reidy**
*BSc, MAusIMM*

For:

Ernst & Young Transaction Advisory Services Ltd
The Ernst & Young Building
11 Mounts Bay Road
WA 6000
Australia

Approved:

Daniel Wholley
Director

2nd March 2012
The Directors
Ernst & Young Transaction Advisory Services Ltd
11 Mounts Bay Road
Western Australia 6000

Dear Sirs,

**Re; Valuation of mineral assets – Zara Gold Project Eritrea**

CSA Global Pty Ltd ("CSA") has been commissioned by Ernst & Young Transaction Advisory Services Ltd ("Ernst & Young") to provide an Independent Technical Valuation ("this Report") of the mineral assets of Chalice Gold Mines Limited ("Chalice" or the "Company") at the Zara Gold Project excluding those Mineral Resources currently estimated at the Koka Gold Deposit. These mineral assets are comprised of a 60% ownership in three tenements – Zara North, South and Central ("Zara Tenements").

This Report is intended to review the exploration and evaluation programs completed to date at Zara, and is to be included in an Independent Expert's Report ("the IER") by Ernst & Young in relation to the cash offer by China SFECO Group ("SFECO") to acquire Chalice's 60% interest in the Zara Mining Share Company ("ZMSC").

CSA has not been asked to comment on the fairness or reasonableness of any vendor considerations, and we have therefore not offered any opinion on these matters.

CSA has based its valuation of the Zara Tenements on information available to the principal author and by investigations of published and unpublished data as well as on information provided by Chalice. CSA has relied upon discussions with Chalice management, recent company exploration reports, and independent technical reporting for information contained within this valuation. A site visit has not been made to the mineral asset under consideration as CSA is satisfied that there is sufficient information available to allow an informed appraisal to be made without an inspection.

This Independent Technical Report has been prepared in accordance with the Code and Guidelines for Assessment and Valuation of Mineral Assets and Mineral Securities for Independent Expert Reports (the "VALMIN Code"), which is binding upon Members of the Australasian Institute of Mining and Metallurgy ("AusIMM"), and the Australian Institute of Geoscientists ("AIG") when preparing such reports.

This Report is complete up to and including 2 March 2012. CSA has provided and not withdrawn written consent for the inclusion of the valuation of the Zara Tenements in the IER, and to the inclusion of statements made by CSA and to the references of its name in other sections of the document, in the form and context in which this Report and those statements appear.

CSA accepts responsibility for this Report for the purposes of an Independent Expert's Report under the ASX Rules. Having taken all reasonable care to ensure that such is the case, CSA and the authors confirm that, to the best of their knowledge, the information contained in this Independent Technical Report is in accordance with the facts, contains no omission likely to affect its import, and no change has occurred from March 2012 to the date hereof that would require any amendment to the Independent Technical Report

The primary author of the report is CSA's associate consultant geologist, Paddy Reidy (B.Sc. 1994) a Member of the Australasian Institute of Mining and Metallurgy AusIMM, who has worked for 16 years as a professional geologist with experience in the evaluation and mining of mineral properties within Australia and worldwide. Mr Reidy has the relevant qualifications, experience, competence and independence to be considered an "Expert" under the definitions provided in the VALMIN Code.

Neither CSA nor any of the CSA staff or the author of this Report have or have previously had any material interest in Chalice Gold Limited, SFECO, or the mineral properties which are the subject of this report. CSA, Paddy Reidy and Daniel Wholley are independent of the Company, the Directors, senior management of the Company and its other advisers. The relationship with Chalice is solely one of professional association between client and independent consultant. This report is prepared in return for professional fees based upon agreed commercial rates and the payment of those fees is in no way contingent on the results of this Report.

Yours faithfully

CSA Global Pty Ltd

Director

# Executive Summary

This Valuation Report has been prepared at the request of by Ernst & Young Transaction Advisory Services Ltd ("Ernst & Young") on behalf of Chalice Gold Mines Limited ("Chalice" or the "Company") in relation to the cash offer by China SFECO Group ("SFECO") to acquire Chalice's 60% interest in the Zara Mining Share Company ("ZMSC").

Specifically, this report considers the market value of the Zara Gold Project excluding those Mineral Resources currently estimated at the Koka Gold Deposit ("Koka"). These mineral assets are comprised of a 60% ownership in three licences – Zara North, South and Central, where the remaining 40% is owned by the Eritrean National Mining Corporation ("ENAMCO") following the completion of an agreement to sell 30% of the project to ENAMCO which is in addition to the 10% free carried interest in the project already held by ENAMCO.

The Zara Gold Project is situated in northern Eritrea, approximately 160km northwest of the capital Asmara.

The first drilling at the Koka discovery commenced in August 2005 and resulted in the confirmation of gold mineralisation beneath artisanal workings. The drilling consisted of four diamond drillholes about 150m apart, returning significant gold mineralisation in all four holes. A systematic diamond drilling programme covering the known strike of artisanal workings commenced in January 2006 and following a number of successful campaigns high grade gold mineralisation was defined over a strike length of 650m at Koka up to 2011.

The Koka deposit contains a Probable Reserve of 4.6 million tonnes of ore grading 5.1 grams of gold per tonne. This is contained within an Indicated Mineral Resource which was estimated by AMC Consultants Pty Ltd ("AMC") in June 2010 (Table 1).

**Table 1. Koka Gold Deposit Mineral Resource (June 2010) at 1.2 g/t cut off**

| Category | Tonnes (Mt) | Grade (Au g/t) | Contained Gold (Oz) |
|---|---|---|---|
| Indicated Resource | 5.0 | 5.3 | **840,000** |

A feasibility study was completed in July 2010 which has indicated that open cut development of the Koka deposit is economically robust with planned gold production averaging 104,000oz per annum over 7 years at a forecast operating cost of US$338/oz.

Following the signing of a Shareholders Agreement between Chalice and ENAMCO in July 2011, an application was made for the Koka Mining Licence. On 16 January 2012 Chalice announced that its 60% owned subsidiary, ZMSC had been granted two Mining Licences covering Koka at the Zara Project. The two licences cover an area of 16.4km$^2$, and are valid for a minimum of 18 years.

For the purposes of the asset valuation, and in consideration of the various stages of development of the licences and prospects at Zara, the mineral assets have been evaluated in four separate components as follows –

1. Koka South prospect
2. Zara Central Licence excluding Koka South (including Debre Konate, and Koka-Konate-Fah corridor)
3. Zara North Licence
4. Zara South Licence

Valuation of these four components is based upon the Appraised Value Method which considers the costs and results of historical exploration, and whether these programs have succeeded in enhancing the prospectivity of the mineral asset.

The value of the Chalice 60% ownership of the Zara Gold Project (excluding the Koka Gold Deposit) lies in a range from **US$14M** to **US$20M** with a preferred value of **US$17.5M** (Table 2).

**Table 2. Zara Gold Project Summary Valuation**

| Prospect / Licence Area | Low Value US$M 60% equity | High Value US$M 60% equity | **Preferred Value US$M 60% equity** |
|---|---|---|---|
| Koka South Prospect | 4.7 | 7.0 | **5.8** |
| Zara Central (excluding Koka and Koka South) | 7.9 | 9.5 | **9.5** |
| Zara North | 1.1 | 1.9 | **1.5** |
| Zara South | 0.7 | 1.3 | **0.7** |
| Total | **14.4** | **19.7** | **17.5** |

All references to units of currency in this Report are to Dollars of the United States (“$” or “US$”), unless stipulated as Australian Dollars (“A$”). Standard abbreviations used are grams gold per tonne (“g/t”), kilometres (“km”), metres (“m”), million (“M”), troy ounces gold (“oz”) and tonnes (“t”).

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# 1 Introduction

## 1.1 Context, Scope and Terms of Reference

Chalice Gold Mines Limited ("Chalice") is a public company listed on the Australian Securities Exchange and on the Toronto Stock Exchange. Chalice has a 60% interest in the Zara Gold Project ("Zara") in Eritrea through its wholly owned subsidiary Zara Mining Share Company.

CSA Global Pty Ltd ("CSA") has been commissioned by Ernst and Young in relation to mineral assets at the Zara Gold Project located in northern Eritrea. Specifically, this report considers the market value of the assets excluding those Mineral Resources currently estimated at the Koka Gold Deposit ("Koka").

Neither CSA, nor the author of this report, has or has had previously, any material interest in Chalice or the mineral properties in which Chalice has an interest. CSA's relationship with Chalice is solely one of professional association between client and independent consultant.

CSA is an independent geological consultancy. Fees are being charged to Chalice at a commercial rate for the preparation of this report, the payment of which is not contingent upon the conclusions of the report. No member or employee of CSA is, or is intended to be, a director, officer or other direct employee of Chalice. No member or employee of CSA has, or has had, any shareholding in Chalice. There is no formal agreement between CSA and Chalice as to CSA providing further work for Chalice.

The statements and opinions contained in this report are given in good faith and in the belief that they are not false or misleading. The conclusions are based on the reference date of the 2nd March 2012 and could alter over time depending on exploration results, mineral prices and other relevant market factors.

## 1.2 Reporting Standards

The Valuation has been prepared in accordance with the Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves 2004 Edition ("JORC Code"), which sets out minimum standards, recommendations and guidelines for Public Reporting of Exploration Results, Mineral Resources and Ore Reserves. The JORC Code is binding upon members of The Australasian Institute of Mining and Metallurgy ("AusIMM") and the Australian Institute of Geoscientists ("AIG") when preparing such reports.

The Code for the Technical Assessment and Valuation of Mineral and Petroleum Assets and Securities for Independent Expert Reports" ("VALMIN Code") is binding upon members of the AusIMM and the AIG when they are involved in the preparation of Public Independent Expert Reports that are required by legislation such as the Australian Corporations Act 2001, or by the listing rules of the ASX or of other recognised Stock Exchanges.

This Report has been prepared to conform to the VALMIN Code and it has also been prepared having due regard to ASIC Regulatory Guide 111 – Content of Expert Reports, and ASIC Regulatory Guide 112 – Independence of Experts.

### 1.3 Principal Sources of Information

This review is based on the information provided by the current tenement holders, technical reports of consultants and previous explorers, as well as other published (see Bibliography) and unpublished data relevant to the area, including public domain data.

The author has endeavoured, by making all reasonable enquiries, to confirm the authenticity and completeness of the technical data upon which this report is based. Chalice was provided a draft of this report excluding the parts relating to the valuation and requested to identify any material errors or omissions.

A site visit has not been made to the mineral asset under consideration as CSA is satisfied that there is sufficient information available within recent and relevant independent consultants reports to allow an informed appraisal to be made..

### 1.4 Property Location, Access and Infrastructure

The Zara Project is situated approximately 165 kilometres northwest of Asmara, the capital of the State of Eritrea in northeast Africa (Figure 1). The project is located in a range of mountains running parallel to the Zara River which drains north into Sudan.


**Figure 1. Project Location – Zara Gold Project**

The main access to the study area is through the asphalt road from Asmara to Keren and then through the road through Hamelmalo, Melebso and Asmat to Rikeb. The climate is subtropical with distinct dry and rainy seasons with the wet season spanning May through to September (dominantly July to August). In general the rainy season in the project area is of very short duration and erratic and drought is a common occurrence. The mean annual precipitation in the arid lowland zone ranges from 200 mm to 500 mm, the mean annual temperature ranges from 21ºC to 29ºC and the potential evapo-transpiration ranges from 1,800 mm to 2,000 mm. Based on site data, the total rainfall in 2008 was 117.4 mm and temperatures at site in 2008 ranged from a low of 17ºC in March to a high of 45ºC in May. The topography of the project area is dominated by steep-sloped mountains, ridges and valleys, with an elevation ranging between 500m above sea level along river beds and 2000m above sea level at the mountain crests. Most of the flat areas are located along the river banks or along the river beds (Figure 2).

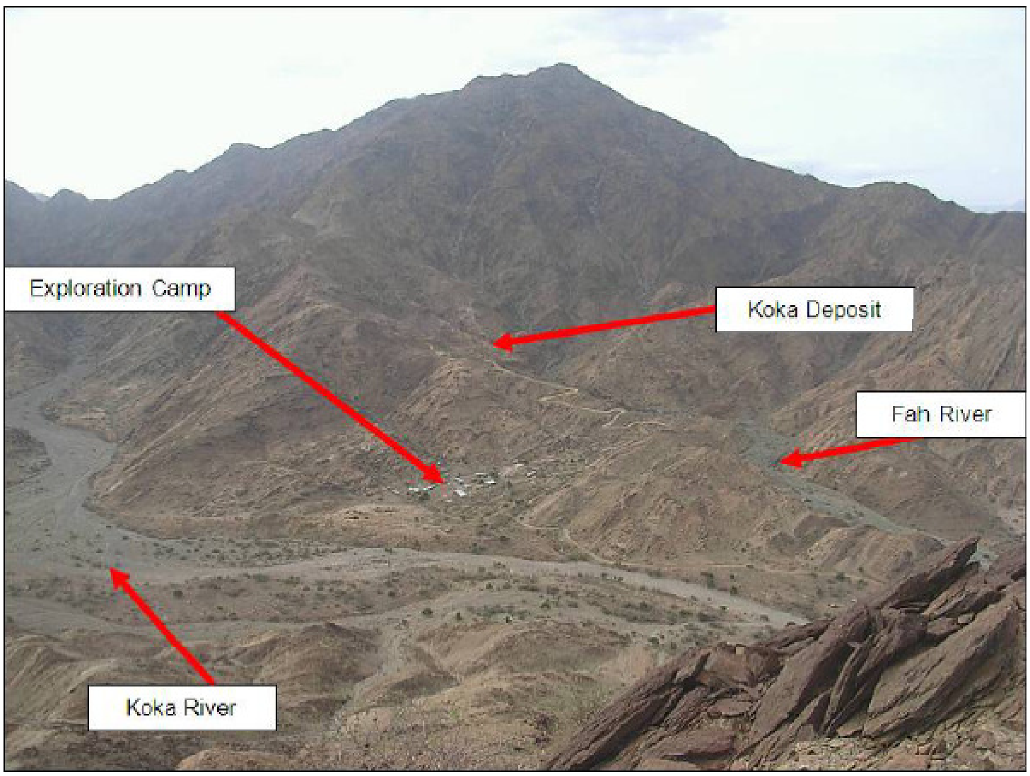



**Figure 2. Topography looking east across the Koka River valley to the Koka Gold Deposit**

## 1.5 Eritrean Mineral Tenure

The legal framework governing mining and related activities within Eritrea is embodied in a Mining Law governed primarily by the following three statutes:

- Minerals Proclamation No. 68/1995
- Mining Income Tax Proclamation No. 69/1995
- Regulations on Mining Operations Legal Notice No. 19/1995

All mineral resources in Eritrea are public property, and it is recognised that the State has a duty to ensure the conservation and sustainable development of these resources for the benefit of the people. The stated intention of Minerals Policy in Eritrea is to create a favourable atmosphere for foreign investment in the mining sector with due recognition given to the significant role that foreign investment and skills can play in the development of this sector and the capital intensive, long term and risky nature of mining investments. The Minerals Policy also recognises the necessity for the formulation of regulations which will ensure protection of the natural environment, together with sustainable development of the country's mineral resources, in accordance with sound principles of resource management and land use.

Eritrean Mining Law permits the following types of licenses:

- Prospecting License – valid for one year and non-renewable;
- Exploration License – valid for an initial period of three years, but which may be renewed twice for additional terms of one year each, with the option for further renewals in appropriate circumstances;
- Mining License – valid for a period of twenty years with optional ten year renewals.

All of these licenses are exclusive and grant their holders an automatic right to obtain an Exploration License from within a Prospecting License and a Mining License from within an Exploration License, subject to the fulfilment of the obligations under the preceding license.

The maximum area that a single license can cover is fixed at:

- Prospecting License–100km$^2$
- Exploration License–50km$^2$
- Mining License–10km$^2$

Simultaneous possession of multiple contiguous licenses is permitted. Applications for any of these licenses may be made by individuals or legal entities of any nationality. All applications are to be made on specified forms that can be obtained from the Department of Mines of the Ministry of Energy and Mines.

# 2 Geological Setting and Metallogeny

## 2.1 Regional Setting

Neoproterozoic metamorphic rocks outcrop over much of northern and central Eritrea. These rocks were accreted onto the Arabian-Nubian Shield and then deformed between 900 Ma and 550 Ma. They can be subdivided into four terrains, which from east to west are referred to as the Nakfa, Adobha Abiy, Hagar and Barka terrains. These terrains are separated by major, crust-breaking, east-northeast trending deformation zones. The Zara Project is situated within rocks assigned to the Nakfa and Adobha Abiy terrains (Figure 3), within a flexure in the Elababu Shear Zone which separates the Adobha Abiy and Nakfa terrains.

The eastern and central parts of the Zara exploration licenses are underlain by metavolcanic and meta-sedimentary rocks metamorphosed to greenschist facies, together with post-tectonic granitoids, assigned to the Nakfa terrain. The western part is underlain by predominantly siliciclastic rocks, together with minor meta-chemical sedimentary rocks, basalt and syn-tectonic granitoids assigned to the Adobha Abiy terrain. The Koka mineralised zone has a total strike length of more than 650m and lies adjacent to the sheared and altered contact between a sequence of meta-sedimentary and metabasaltic rocks in the west (footwall) and a meta-volcanic and meta-volcaniclastic sequence, intruded by granitoid bodies, to the east (hangingwall) within the Nakfa terrain. The meta-sedimentary rocks comprise tuffaceous greywackes, siltstones, and shales with minor mafic intrusive rocks. This sequence is isoclinally folded. The meta-volcanic and meta-volcaniclastic sequence comprises more massive, principally intermediate and acidic, pyroclastic rocks and intrusions of microgranite and micrographic microgranite together with minor rhyolite and dacite.

The contact between these two major sequences is linear, sharp and sub-vertical to steep easterly dipping and orientated approximately north-south. It is strongly sheared and mylonitised. The contact is sub-parallel to a pervasive regional fabric, developed particularly in the finer grained rocks, that also dips steeply to the east.

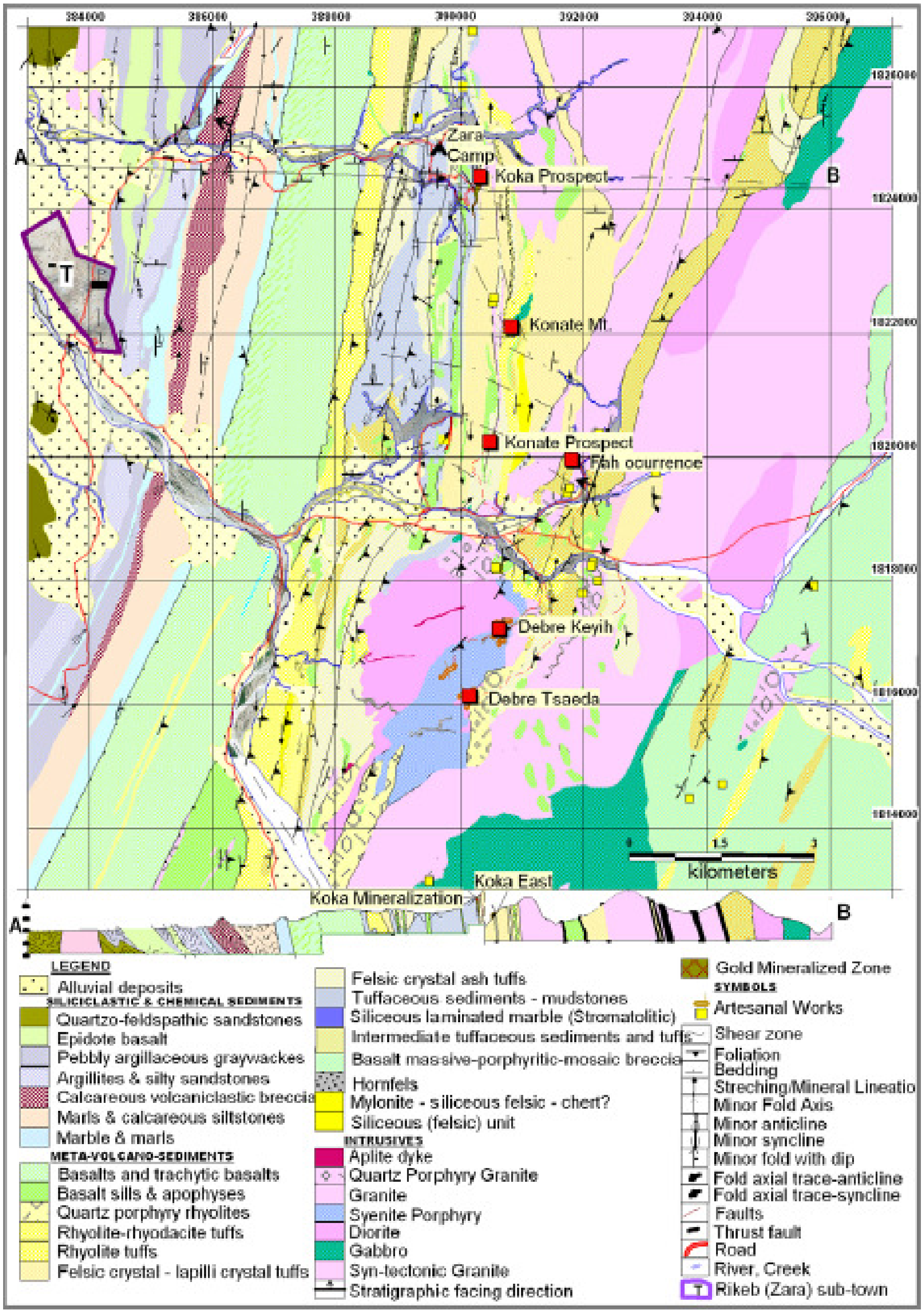



**Figure 3. Regional Geology of the Zara Gold Project area**

## 2.2 Metallogeny

The Koka deposit is considered to be a greenschist facies, orogenic gold deposit. This style of deposit is present in metamorphic terranes of various ages, and they display variable degrees of deformation.

The host geological environments at Koka include volcano-plutonic and clastic sedimentary terranes, both of which comprise the sequence of host rocks encompassing the microgranite, which in turn hosts the auriferous quartz veins at Koka. The Koka host rocks have been metamorphosed to lower greenschist grade, with marginally higher metamorphic grade (mid- to upper-greenschist) evident at the Konate prospect several kilometres along strike to the south of Koka

Orogenic gold deposits typically occur within, or in the vicinity of, regional, crustal-scale deformation zones with a brittle to ductile style of deformation. The overall geological architecture of northern Eritrea is dominated by a north-northeast to north striking shear zone that separates predominantly gneiss and intrusion-dominated lithologies in the east from dominantly sedimentary and ultramafic (ophiolitic) lithologies in the west. The shear diverges at the southern end and comprises an eastern shear, the Elababu Shear Zone, and a western shear, the Baden Shear Zone. Koka is located in the Nakfa Domain and lies immediately to the east of a major flexure in the Elababu Shear Zone.

Typically, there is a strong structural control to mineralisation in orogenic gold deposits. Depending on physical and chemical conditions, the characteristics of the host and feeder structures can be highly variable. Host structures include brittle faults, ductile shear zones, extensional fractures, stockworks, breccias, and fold hinges. Given that the structural controls to orogenic gold deposits operate at all scales, it is common for more than one structural site to host mineralisation.

At the deposit-scale the competent Koka microgranite has failed in a brittle fashion during contractional deformation, allowing ingress of silica-carbonate bearing fluids and deposition of the veins that host the gold. The quartz-carbonate veins at Koka comprise a stockwork that exhibits two principal orientations. Quartz veins were deposited progressively, coeval with ongoing deformation, resulting in a second-order stage of fracturing and brittle-ductile shearing that has overprinted the veins. Gold-sulphide mineralisation was deposited during the later stages of this progressive deformation event. At the scale of the veins the gold is hosted by marginal shears on the boundaries of the quartz veins.

As with many orogenic gold deposits, Koka exhibits the same style of veining from surface to the vertical extent of current drilling.

## 2.3 Zara Gold Project

### *2.3.1 Project Tenure*

The original prospecting license covering the Koka deposit was issued by the Department of Mines at the Eritrean Ministry of Energy and Mines on the 2 October 1998, and converted to 4 exploration licenses for a period of 5 years on the 20th October 2000. Upon this conversion from prospecting licence to exploration licences the area was reduced by 204km$^2$

to a total of 196km$^2$. In November 2008, the Zara Central licence area covering the Zara 1,2,3 and 4 licences was reduced to 147km$^2$.

On the 26th March 2010, the authorisation for extension of the Zara 1, 2, 3 and 4 Exploration Licences was granted. The Licence was renewed on condition that the Bankable Feasibility Study (BFS), the Social and Environmental Impact Assessment (SEIA) and the Social and Environmental Management Plan (SEMP) on the Koka Deposit would be completed by the 26$^{th}$ May 2011. These conditions were met and the Zara Central Licence was renewed for a further 1 year with a further drop off of 28.4km$^2$.

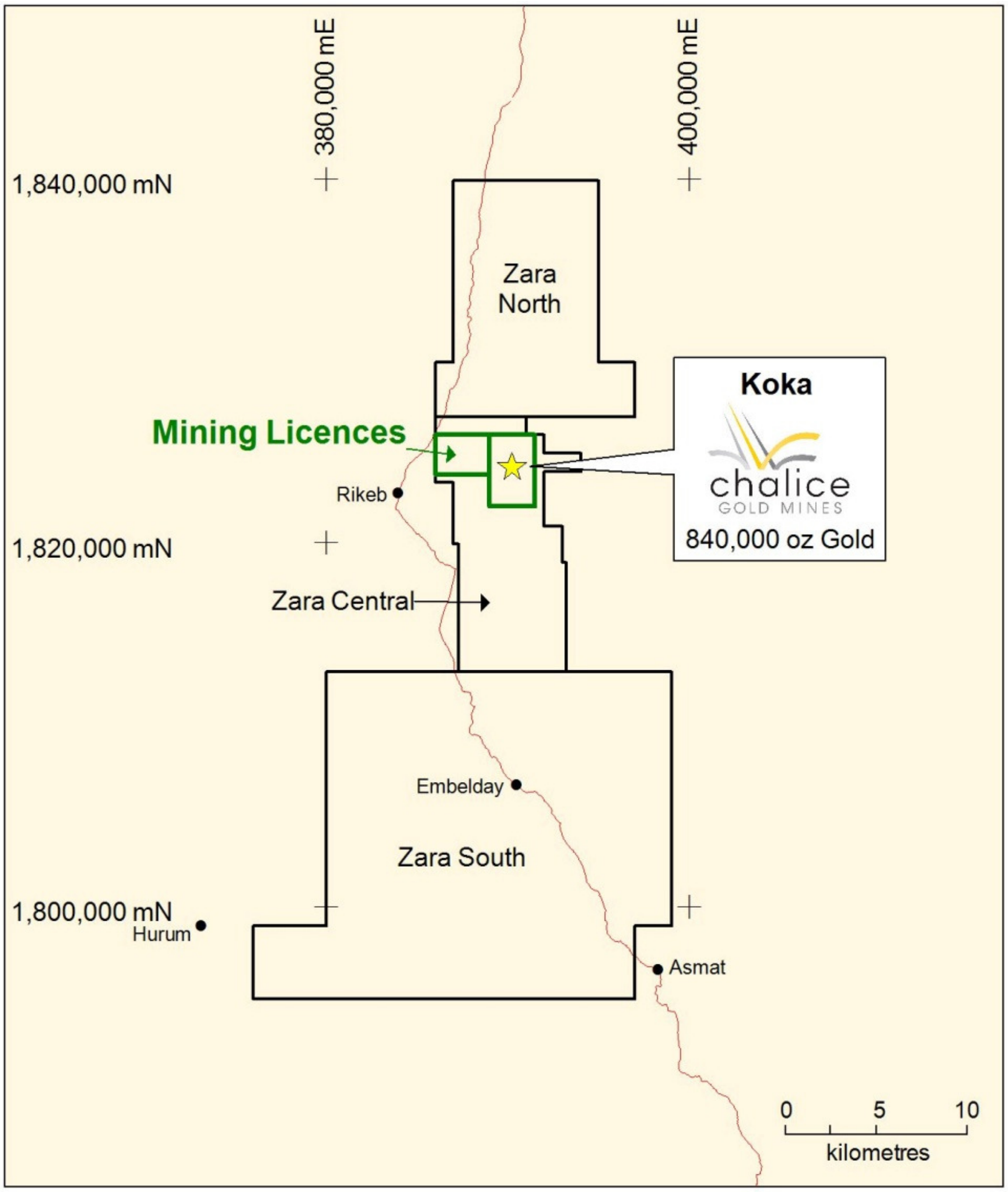



**Figure 4. Zara Project Licence areas including granted Mining Licences**

Two Mining Licences ML 01/2012 and ML 02/2012 were granted on 16th January 2012 covering the Koka deposit, over an area of 16.4km$^2$ (Figure 4). The licences are valid for a minimum of 18 years.

The Zara North and South Licences were initially granted as Prospecting Licences on 20th August 2009. They were converted to Exploration Licences on 26th January 2011 for a period of 3 years (Table 3).

Chalice currently hold 100% ownership in two other licences at Mogoraib North and Hurum, however these licences are outside of the Zara project and are not considered in this review and valuation.

**Table 3. Zara Project Tenement Details**

| Licence Name / Number | Licence Type | Holding (%) | Granted | Expiry | Area km$^2$ | Annual Rent US$ |
|---|---|---|---|---|---|---|
| Zara Central | Exploration | 60 | 25/05/2011 | 24/05/2012 | 82.0 | 1091 |
| Zara North | Exploration | 60 | 26/01/2011 | 25/01/2014 | 113.4 | 1509 |
| Zara South | Exploration | 60 | 26/01/2011 | 25/01/2014 | 351.4 | 4673 |
| ML 01/2012 | Mining | 60 | 16/01/2012 | 15/01/2030 | 9.8 | - |
| ML 02/2012 | Mining | 60 | 16/01/2012 | 15/01/2030 | 6.6 | - |

### *2.3.2 Koka Gold Deposit Geology and Mineralisation*

The gold mineralisation at Koka is developed principally within an elongated lensoid body of microgranite intruded along the western margin of the metavolcanic and meta-volcaniclastic succession (Figure 5). This unit has been strongly silicified and brecciated and is cut by a stockwork of quartz veins. There is a considerable competency contrast between this unit and the meta-sedimentary and meta-basaltic sequence immediately to the west. This competency contrast is believed to be significant in locating both deformation and mineralisation. The meta-sedimentary rocks behaved competently, whereas the meta-volcanic and meta-volcaniclastic sequence behaved incompetently resulting in brecciation and multiple phases of quartz veining.

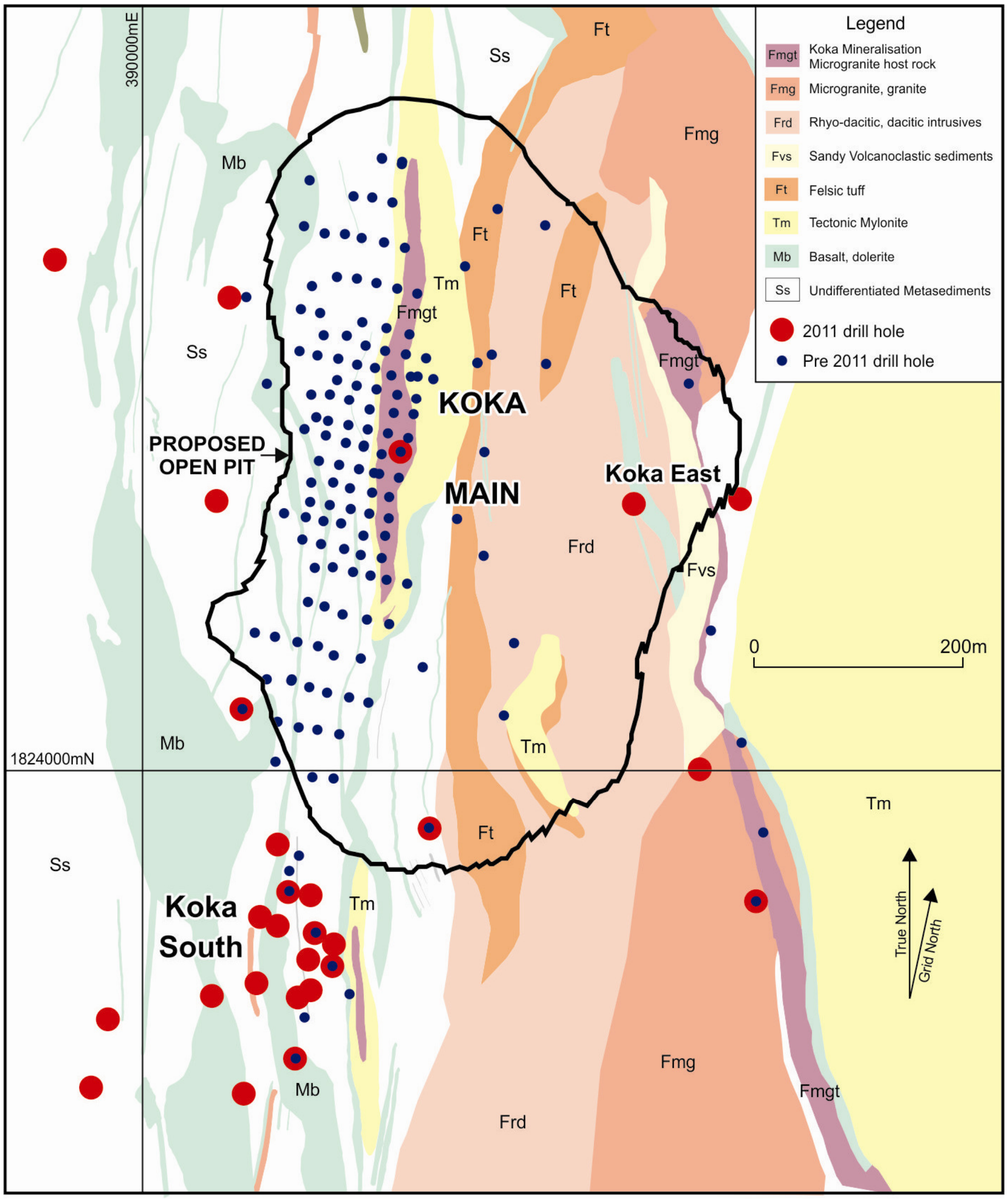



**Figure 5. Koka Deposit Geology**

The western contact of the microgranite is the conduit for a zone of intense carbonation and sericitisation up to 20m wide. Multi-element geochemical patterns indicate that this zone is enriched in Ca, Mg, K and Fe. Within 50m to 80m of this major contact, the multi-element geochemical patterns outline a second zone of intense alteration within the microgranite only 10m wide, also enriched in Ca, Mg, K and Fe. To the east of this second zone of intense alteration, the microgranite is pinkish in hue due to the appearance of potassic feldspar and shows less evidence of alteration. It is cut by later basaltic intrusives. The footwall contact of the microgranite hosting gold mineralisation is the contact between the meta-sedimentary rock and the microgranite. No anomalous gold mineralisation has been intersected in any of the footwall rocks. The hangingwall contact of mineralised microgranite is taken as the first appearance of unaltered, pinkish, potassic feldspar-bearing microgranite. The mineralisation lies within this 50m to 80m wide zone. It is preferentially located closer to the footwall contact and is intimately associated with a stockwork of quartz veins. In some of the wider gold intersections the higher grades and more continuous mineralisation are found closer to the sharp footwall contact, whereas the hangingwall contact of the mineralisation is more diffuse.

Fracturing, veining and mineralisation particularly affected the microgranite, possibly because it was a structurally competent unit which fractured in response to deformation. Thin brittle fractures and open fractures encouraged invasion of the rock body by abundant mineralising hydrothermal fluid composed mainly of $H_2O$ and $CO_2$, with minor other dissolved components including S, Zn, Pb, Cu, Au and possible Sb. Thin fracture networks were sealed by fine-grained foliated sericite ± carbonate (dolomite), and are now observed as thin pale yellowish green fracture fillings in white host rock which suffered selective pervasive replacement by the alteration assemblage albite + minor sericite + carbonate (dolomite) + opaques (pyrite ± inclusions of sphalerite, galena) + trace leucoxene. Primary quartz and zircon are preserved, and primary potassic feldspar has survived in pale pinkish cream rocks that have suffered lower intensity of alteration. Rare small grains of gold occur adjacent to veins.

Limited post-vein deformation has generated shadowy strain extinction in vein quartz and thin micro-cracks in vein pyrite. It has also caused local remobilisation of galena, sphalerite and trace gold for short distances along some micro-cracks.

### *2.3.3 Koka South Geology and Mineralisation*

The Koka South prospect, located immediately along strike to the south of the Koka deposit has been drilled in a number of campaigns following up on initial high grade mineralisation of up to 1 metre grading 92 g/t Au associated with Koka-style quartz stockwork mineralisation in altered microgranite (Figure 6).

Following the most recent drill results in January 2012, mineralisation has now been delineated over a strike length of 250 metres and remains open to the south and at depth. The drilling has confirmed that gold mineralisation is hosted by a mixed microgranite and porphyry intrusive body which shows various degrees of brecciation and quartz stockworking. The mineralisation is invariably accompanied by accessory amounts of galena and sphalerite (lead and zinc sulphides) which are increasingly recognized as critical pathfinder minerals at Koka.

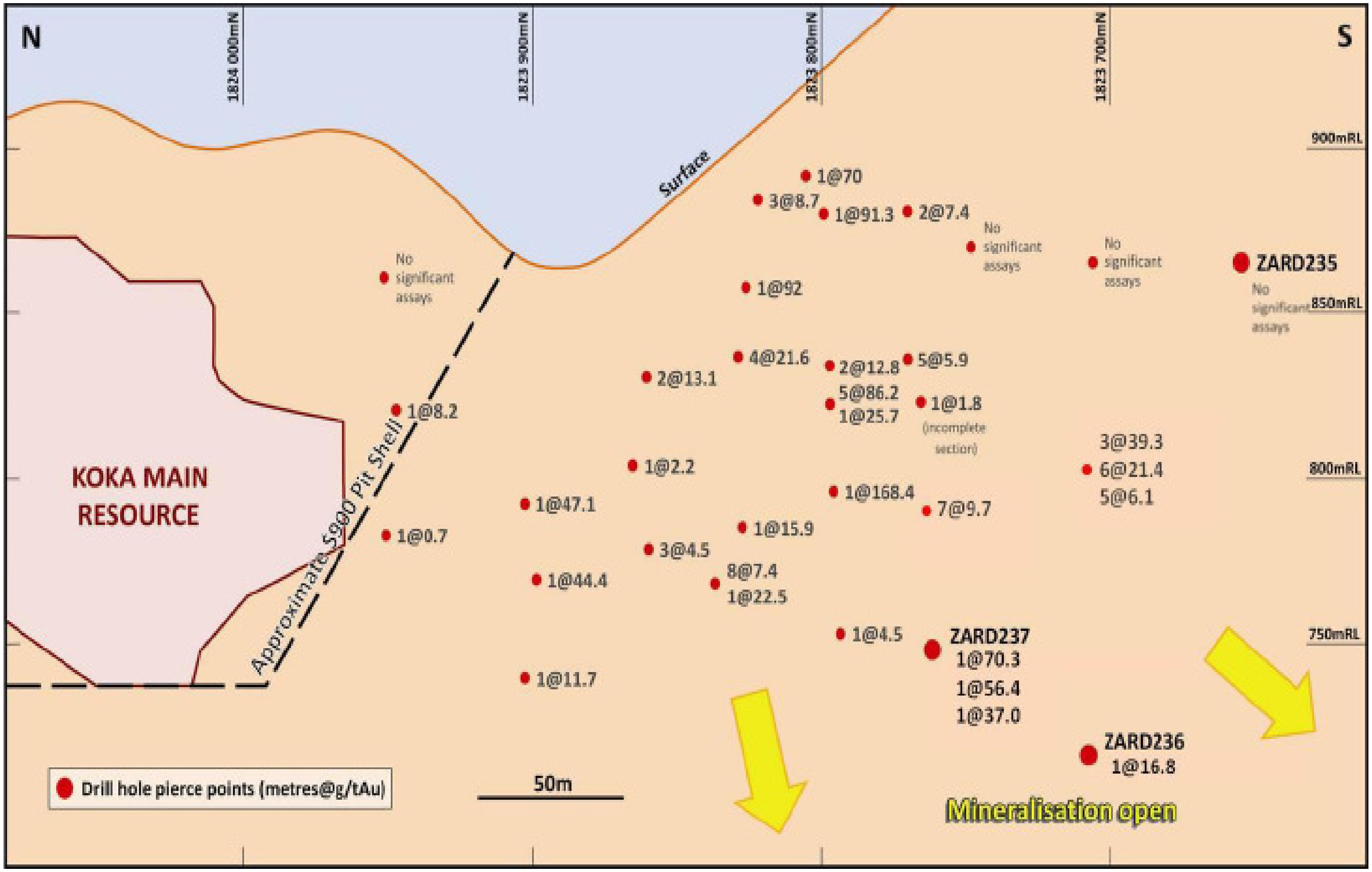



**Figure 6. Koka South – schematic long section showing drillhole pierce points and main intercepts**

### *2.3.4 Konate and Debre Konate Geology and Mineralisation*

Results from a key deep penetration Induced Polarisation (IP) survey over the Koka-Konate corridor reveal numerous strong IP resistivity targets along a 7.5 km long strike length (Figure 7) which are interpreted to reflect strong silicification associated with gold mineralisation. In many cases these are coincident with soil gold anomalies (Figure 8) and in some cases with artisanal workings.

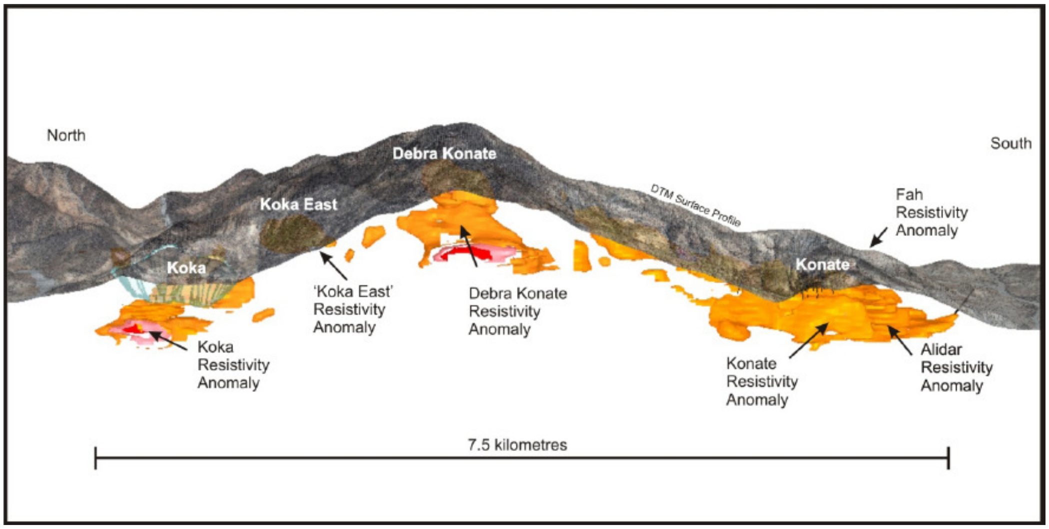



**Figure 7. Long section - Koka-Konate corridor IP resistivity anomaly drill targets**

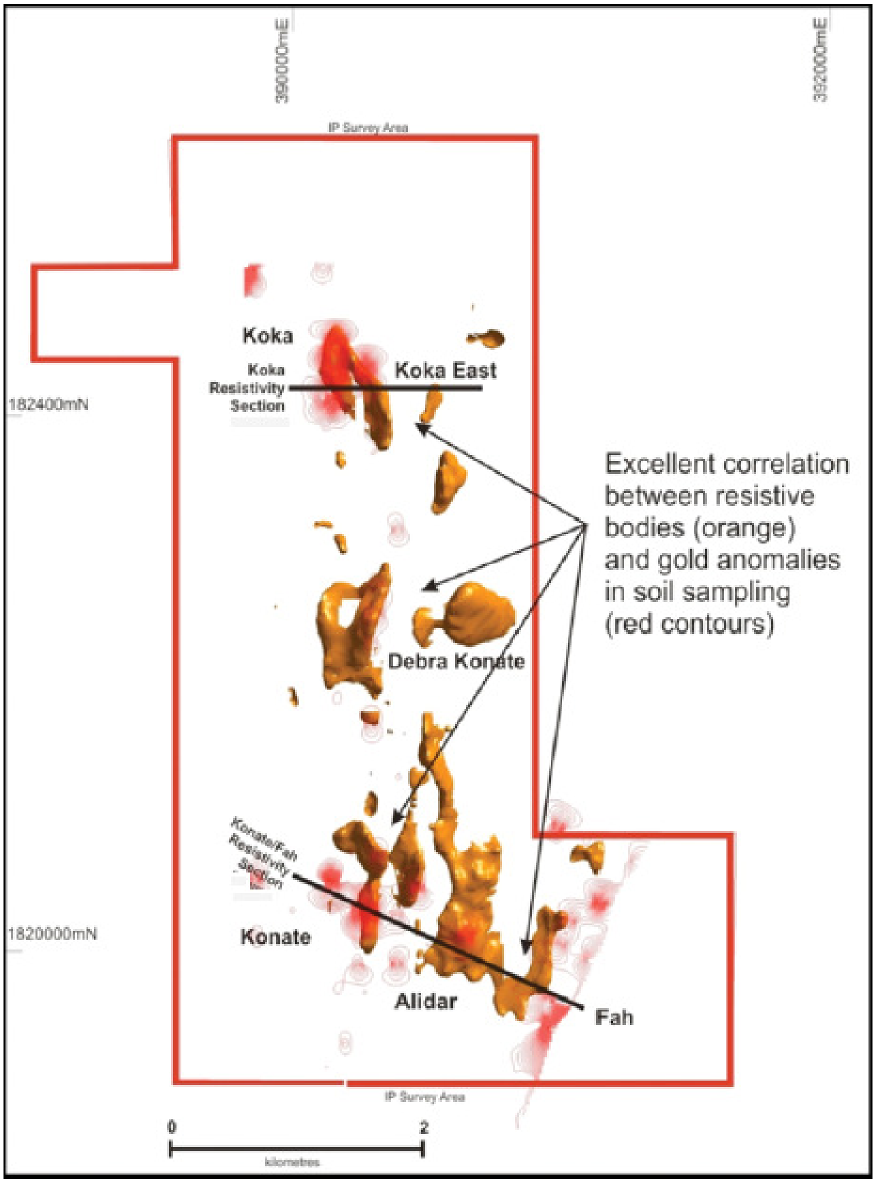



**Figure 8. IP Resistivity Anomalies (brown) over gold content in soil (red contours)**

Drilling of these targets commenced in late May 2011, with a nominal program of 8-10,000 metres of diamond core drilling planned. The Debre Konate prospect, located approximately 2.5km south of Koka, was initially targeted as an Induced Polarisation resistivity anomaly supported by minor artisanal workings and a significant gold and lead soil geochemical anomaly in a microgranite host. ZARD 227 was the first hole drilled into this prospect and it intersected an extensive low-grade mineralised system (Figure 9) grading 0.93g/t gold (uncut) over 199 metres (83m to 282m down-hole).

Drill hole ZARD230 was drilled up dip from ZARD227 and confirmed the previous drill results with numerous zones of narrow, higher grade mineralisation contained within a low-grade envelope. Overall, ZARD230 intersected the same extensive low-grade gold system, returning 111m @ 1.41g/t gold (uncut) from 94m. Better intersections (uncut) included:

- **4m @ 11.45g/t Au** from 94m
- **1m @ 12.55g/t Au** from 119m
- **1m @ 22.42g/t Au** from 129m
- **1m @ 30.55g/t Au** from 163m

This drilling confirmed a previously unrecognised zone of mineralisation at Debre Konate that appears to have potential for larger, bulk-tonnage styles of mineralisation, similar to Centamin Egypt's Sukari deposit.

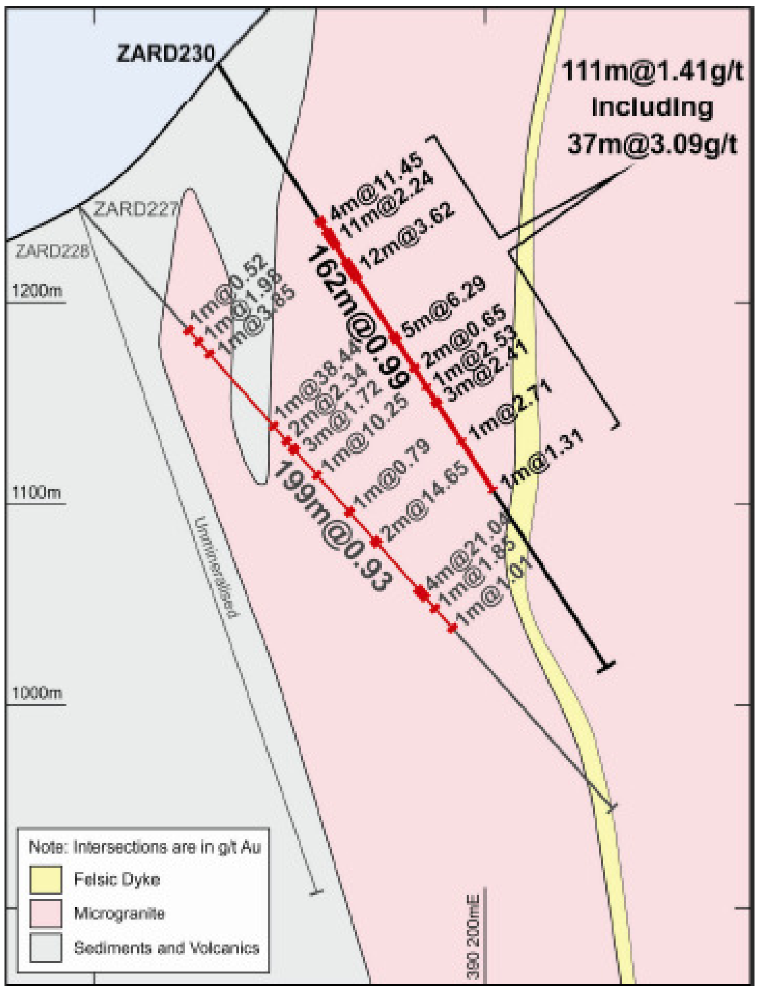



**Figure 9. Cross Section Debre Konate mineralisation**

The Konate prospect ("Konate") is located 5km south and along strike from the Koka deposit and within the Koka-Konate-Fah corridor (Figure 10). In September 2010 Chalice announced that it had discovered a significant new zone of gold mineralisation at Konate which was the first to be drill tested within a 6km long highly prospective corridor, extending to the south of Koka. CSA believes this corridor has the potential to host additional gold mineralisation, similar to that at Koka, where the Company is proposing to develop a high grade, low cost open pit gold mine. The first results from diamond drilling at Konate intersected significant grades and widths of gold mineralisation, with intersections of 3m @ 12.79g/t gold from 120m (drill hole ZARD 177) and 4m @ 11.65g/t gold from 109m (drill hole ZARD 185) within broader zones of lower grade gold mineralisation. ZARD 185 intersected fresh quartz stockwork mineralisation in a microgranite host over a down-hole width of 30m (close to true width) from 109m depth. Better grade mineralisation is associated with higher concentrations of sulphides, predominantly pyrite. The style of mineralisation is similar to the high grade mineralisation at Koka. ZARD 177 was drilled 65m north of ZARD 185 on an oblique 40m section and intersected quartz stockwork mineralisation over a 22m width. Better intersections were again associated with pyrite concentrations and included a high-grade intersection of 3m @ 12.79g/t.

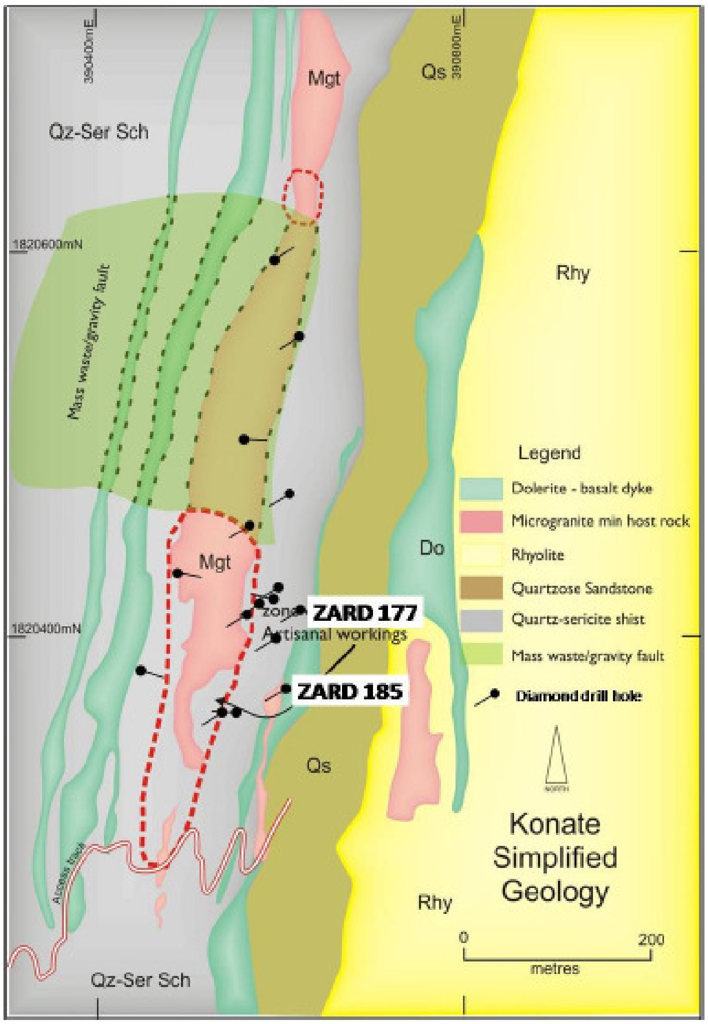



**Figure 10. Konate geology and drilling**

### *2.3.5 Zara North Licence Area*

A reconnaissance Bulk Leach Extractable Gold (BLEG) drainage sampling program has outlined an extensive zone of gold anomalism in the western half of the Zara North licence. Follow-up in-fill sampling using conventional stream sediment sampling confirmed that the anomalism extends over a strike length of approximately 10 km with values up to 876ppb gold recorded. Field checking has identified artisanal workings in several of the anomalous drainages. The anomalism is often associated with a semi-continuous high-strain zone with intense carbonate-sericite alteration and quartz veining over a 30-50m wide zone that extends the length of the anomalous zone. Reconnaissance rock chip sampling along this zone has returned assays of up to 27 g/t gold in grab samples.

Systematic soil sampling has now been completed over the western half of the Zara North licence to define the source of the stream sediment anomalism with 10 mineralised prospects identified within the licence area (Figure 11).

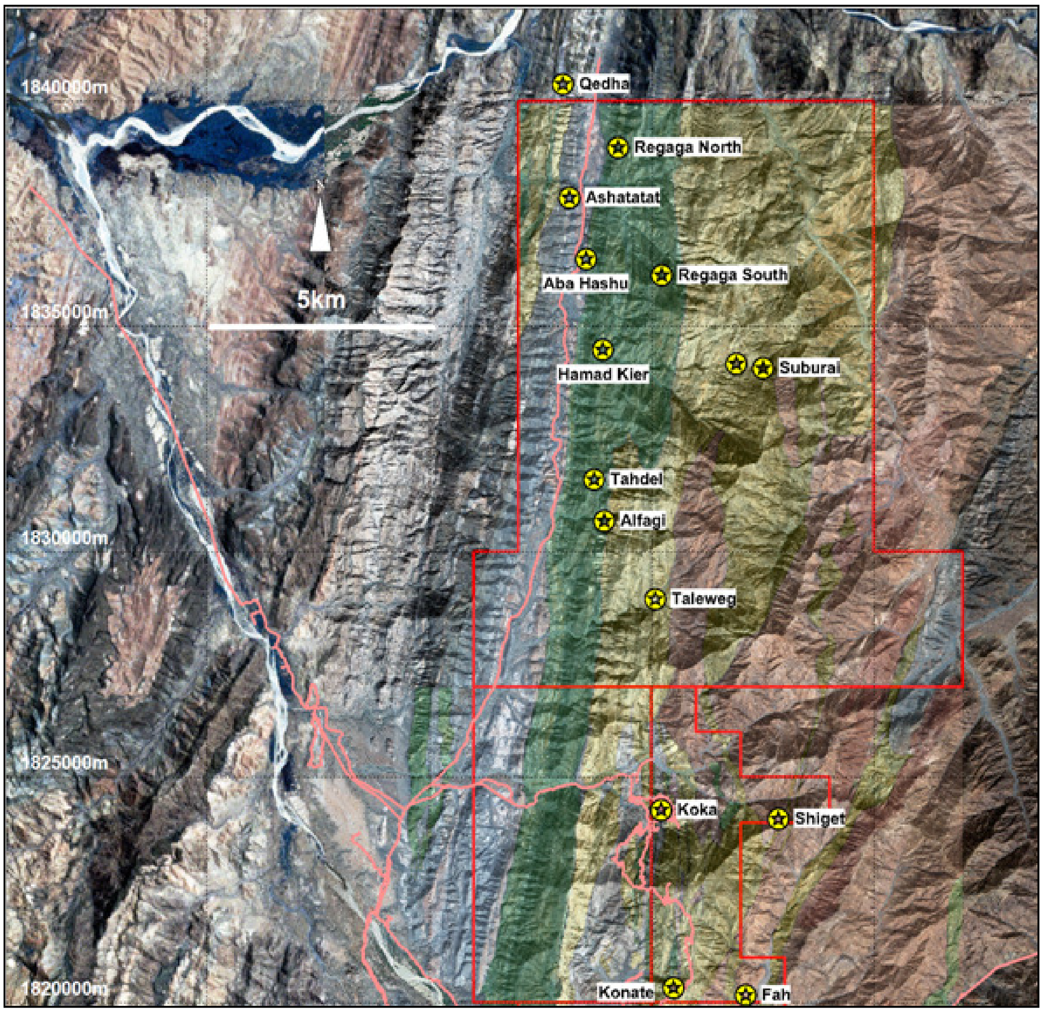



**Figure 11. Zara North Licence area mineralised prospects**

### *2.3.6 Zara South Licence Area*

The Zara South licence has been the subject of several geophysical programs as well as a regional soil geochemical sampling program. Following on from a ground based gravity survey completed in early 2010, a large gravity anomaly was identified in the southern portion of the tenement. A follow-up resistivity survey was conducted over the anomaly in May 2010, however it was found that the anomaly was not supported by a conductive zone which may have indicated the presence of Volcanogenic Massive Sulphide ("VMS") style mineralisation.

A program of BLEG sampling, rock-chip sampling and geological mapping was carried out on the Zara South licence in June 2010, which identified a number of gold anomalies and alteration zones with gold potential which have yet to be fully explored.

# 3 Mineral Resources

## 3.1 Mineral Resource Summary

### *3.1.1 Koka Deposit*

The most recent Mineral Resource estimate for Koka was completed by AMC Consultants Pty Ltd in June 2010 (Table 4) using drill data available as at 7 April 2010. The estimate was based upon an interpretation of overlapping gold and sulphide domains reflecting the association of gold with sulphide mineralisation. The domains were interpreted within a broader domain indicating the limits of the microgranite that hosts the gold mineralisation. Gold grade was estimated using Ordinary Kriging. The estimate was prepared according to standard industry practices using Datamine software (Lycopodium, 2010).

**Table 4. Koka Gold Deposit Mineral Resource (June 2010) at 1.2 g/t cut off**

| Category | Tonnes (Mt) | Grade (Au g/t) | Contained Gold (Oz) |
|---|---|---|---|
| Indicated Resource | 5.0 | 5.3 | **840,000** |

The Mineral Resources were estimated in accordance with the guidelines defined by the Joint Ore Reserves Committee in 2004, commonly referred to as the JORC Code (2004). The JORC Code outlines key criteria to consider in Mineral Resource reporting. These include drill density, survey control on drill hole location, knowledge of geology/mineralisation controls (mostly from open pit mining), data quality (incorporating a quality assurance and quality control assay program and data management program) and resource estimation processes which include appropriate upper and lower grade cut-offs.

# 4 Technical Valuation Background

## 4.1 Valuation Methods

The choice of methodology for the valuation of mineral assets, including exploration licences, depends on the amount of data available and the reliability of that data.

The VALMIN Code classifies mineral assets into categories which represent a spectrum from areas in which mineralisation may or may not have been found through to operating mines which have a well defined Ore Reserve: -

- "Exploration Areas" - properties where mineralisation may or may not have been identified, but where a Mineral Resource has not been identified;
- "Advanced Exploration Areas" - properties where considerable exploration has been undertaken and specific targets have been identified that warrant further detailed evaluation, usually by drill testing, trenching or some other form of detailed geological sampling. A resource estimate may or may not have been made but sufficient work will have been undertaken on at least one prospect to provide both a good understanding of the type of mineralisation present and encouragement that further work will elevate one or more of the prospects to the resource category;
- "Pre-Development Projects" - properties where Mineral Resources have been identified and their extent estimated (possibly incompletely) but where a decision to proceed with development has not been made;
- "Development Projects" - properties for which a decision has been made to proceed with construction and/or production, but which are not yet commissioned or are not yet operating at design levels; and
- "Operating Mines" - mineral properties that are in production.

Each of these categories will require different valuation methodologies, but regardless of the technique employed, consideration must be given to the perceived "fair market value". This is described in the VALMIN Code under Definition 34: -

"It is the amount of money (or the cash equivalent of some other consideration) determined by the Expert in accordance with the provisions of the VALMIN Code for which the Mineral Asset or Security should change hands on the Valuation Date in an open and unrestricted market between a willing buyer and a willing seller in an "arm's length" transaction, with each party acting knowledgeably, prudently and without compulsion"

The Fair Market Value of exploration properties and undeveloped Mineral Resources can be determined by four general approaches: Geoscience Factor; Cost; Market and Income

- Geoscience Factor Method seeks to rank and weight geological aspects, including proximity to mines, deposits and the significance of the camp and the commodity sought; not used for mineral resources

- Appraised Value Method considers the costs and results of historical exploration;

- Market Approach Method or Comparable Transaction looks at prior transactions for the property and recent arm's length transactions for comparable properties; and

- The Income Approach is relevant to exploration properties on which undeveloped mineral resources have been identified by drilling and where sufficiently detailed feasibility studies have been completed. Value can be derived with a reasonable degree of confidence by forecasting the cash flows that would accrue from mining the deposit and discounting to the present day ("DCF") and determining a Net Present Value ("NPV").

When considering the valuation of Exploration Areas, and in some cases Advanced Exploration areas, the Appraised Value Method utilises a Multiple of Exploration Method ("MEE") which involves the allocation of a premium or discount to the relevant and effective Expenditure Base (past expenditure) through the use of the Prospectivity Enhancement Multiplier ("PEM"). This involves a factor which is directly related to the success (or failure) of the exploration completed to date. The Expenditure base includes only the current owner's relevant past expenditures.

Guidelines for the selection of a PEM value have been proposed by several authors in the field of mineral asset valuation. Some of these guidelines are as follows:-

"A positive PEM is one that adds to the value of a given exploration expenditure (e.g., core drilling that shows ore-grade mineralization). A positive PEM should generally be in the range of >1.0 to 3.0" (Gregg and Pickering 2007).

"The Prospectivity Enhancement Multiplier ("PEM") which is applied to the effective expenditure therefore ranges from 0.5 to 3.0. The PEM generally falls within the following ranges:

• 0.5 to 1.0 where work to date or historic data justifies the next stage of exploration (but where past expenditure may have discounted some of the property's mineral potential);

• 1.0 to 2.0 where strong indications of potential for economic mineralisation have been identified; and

• 2.0 to 3.0 where ore grade intersections or exposures indicative of economic resources are present." (Onley, P, 1994).

# 5 Technical Valuation

## 5.1 Introduction

Following a review of publicly available information, technical and financial data provided by Chalice, The Income Approach, Appraised Value and the Market Approach Methods were reviewed for their suitability to the Zara Gold Project.

The Income Approach is not considered appropriate to the project as the mineral assets under consideration are at an early stage of development and have not been the subject of the detailed studies required to forecast future cashflows.

The Appraised Value method was selected as being most relevant to the Koka South prospect, Zara North, South and Central licence areas.

For the purposes of valuation, and in consideration of the various stages of development of the licences and prospects at Zara, the mineral assets have been evaluated in four separate components as follows –

1. Koka South Prospect
2. Koka Central Licence excluding Koka South (including Debre Konate, and Koka-Konate-Fah corridor)
3. Koka North Licence
4. Koka South Licence

## 5.2 Koka South Prospect

At Koka South, which is immediately along strike and to the south of the Koka deposit, drilling has defined high grade gold mineralisation of a similar style and grade to that which has been the subject of a positive feasibility study at Koka.

CSA believes that exploration programs to date have been highly successful in delineating high grade mineralisation, which is open at depth. Exploration costs to Nov 2011 are $US3.9M and consist primarily of 5,630 metres of diamond drilling, sampling and associated site costs. This expenditure has significantly enhanced the prospect and can be considered using the Appraised Value method.

Applying the Exploration Base (costs to date) of US$3.9M and a range of PEM's of between 2.0 and 3.0, a range of values for 60% equity of Koka South of **US$4.7M** to **US$7.0M** is derived, within which range a Preferred value of **US$5.8M** (Table 5) has been selected. This valuation reflects the exploration upside and tenor of mineralisation defined at Koka South to date.

**Table 5. Koka South Prospect – Implied Value Range and 60% equity valuation**

| Prospect | Historical Expenditure (US$) | Prospectivity Enhancement Multiplier (PEM) - 60% Equity | | |
|---|---|---|---|---|
| | | 2.0 | **2.5** | 3.0 |
| **Koka South** | 3,879,408 | US$4.66M | **US$5.82M** | US$6.98M |

## 5.3 Zara Central Licence (excluding Koka South Mineralisation)

The Central Licence at Zara has been the subject of a significant exploration effort which has included geophysical surveys, soil geochemistry and drilling. At the Debre Konate prospect recent drilling has intersected extensive low-grade mineralisation with the first 2 holes drilled at the prospect returning 199m @ 0.93g/t (uncut) and 111m @ 1.41g/t (uncut). These results are considered significant as they confirm a previously unrecognised zone which may have the potential to host a larger, bulk-tonnage style of mineralisation.

Valuation of the advanced Debre Konate prospect as well as other geophysical and geochemical anomalies within the 12km$^2$ Koka-Konate-Fah corridor is based upon the Appraised Value Method.

Expenditure up to 30 November 2011 for the Zara Central Licence – excluding expenditure at the Koka deposit and at the Koka South prospect has been evaluated (Table 6) with the Koka South expenditure excluded based upon drill metres completed at the prospect (5,630m drilled at Koka South to date of 12,889m drilled on Central licence area – a 44% split of expenditure).

**Table 6. Historical Licence Expenditure to 30 November 2011**

| Licence Area | Historical Expenditure $US |
|---|---|
| Zara Central | 5,295,212 |
| Zara North | 1,256,653 |
| Zara South | 1,088,363 |
| **Total** | **7,640,228** |

Applying the Exploration Base of US$5.3M and a range of PEM's of between 2.5 and 3.0, a range of values for 60% equity of the Central Licence (excluding Koka and Koka South prospect) of **US$7.9M** to **US$9.5M** is derived, within which range a preferred value of **US$9.5M** (Table 7) has been selected. This valuation reflects the significant exploration potential within the Koka-Konate-Fah corridor as well as significant drill intersections at the Debre Konate prospect.

**Table 7. Historical Expenditure, PEM and 60% equity value Zara Central Licence**

| Licence Area | Historical Expenditure (US$) | Prospectivity Enhancement Multiplier (PEM) 60% Equity | |
|---|---|---|---|
| | | 2.5 | **3.0** |
| Zara Central (excluding Koka and Koka South) | 5,295,212 | US$7.94M | **US$9.53M** |

### 5.4 Zara North and South Licences

Valuation of the Zara North and South Licences is also based upon the Appraised Value Method. Extensive zones of gold anomalism extending over 10km have been defined in the western part of the Zara North tenement. The Zara South tenement has also been the subject of regional soil geochemical sampling.

Applying the Exploration Base of A$1.3M and a range of PEM's of between 1.5 and 2.5, a range of values for 60% equity of the Zara North Licence mineral assets of **US$1.1M** to **US$1.9M** is derived, within which range a preferred value of **US$1.5M** has been selected (Table 8). This valuation reflects the extensive zones of gold anomalism extending over 10km which have been defined in the western part of the Zara North tenement.

Applying the Exploration Base of US$1.1M and a range of PEM's of between 1.0 and 2.0, a range of values for 60% equity of the Zara South Licence mineral assets of **US$0.6M** to **US$1.3M** is derived, within which range a preferred value of **US$0.6M** has been selected (Table 8). This valuation reflects the early stage exploration which has so far been carried out on the licence area and the results to date.

**Table 8. Historical Expenditure, PEM and 60% equity value Zara North and South Licences**

| Licence Area | Historical Expenditure (US$) | Prospectivity Enhancement Multiplier (PEM) - 60% Equity | | | | |
|---|---|---|---|---|---|---|
| | | 1.0 | 1.5 | 2.0 | 2.5 | 3.0 |
| Zara North | 1,256,653 | US$0.75M | US$1.13M | **US$1.51M** | US$1.88M | US$2.26M |
| Zara South | 1,088,363 | **US$0.65M** | US$0.98M | US$1.31M | US$1.63M | US$1.96M |

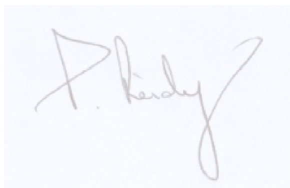
### 5.5 Summary Zara Project Valuation (excluding Koka deposit)

Combining the valuations for the Koka South prospect, and the Zara Central, North and South licence areas as described, a value for 60% equity in the Zara Gold Project (excluding the Koka Gold Deposit) lies in a range from US$14.4M to US$19.7M with a preferred value of US$17.5M (Table 9).

**Table 9. Zara Project Value Ranges and Preferred Value – 60% equity**

| Prospect / Licence Area | Low Value US$M 60% equity | High Value US$M 60% equity | **Preferred Value US$M 60% equity** |
|---|---|---|---|
| Koka South Prospect | 4.7 | 7.0 | **5.8** |
| Zara Central (excluding Koka and Koka South) | 7.9 | 9.5 | **9.5** |
| Zara North | 1.1 | 1.9 | **1.5** |
| Zara South | 0.7 | 1.3 | **0.7** |
| Total | **14.4** | **19.7** | **17.5** |

Signed by:



**Paddy Reidy**
*BSc, MAusIMM*

Date:  8th March 2011

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# Glossary

| | |
|---|---|
| **amphibolite:** | A metamorphic crystalline rock consisting mainly of amphiboles and some plagioclase. |
| **amphibolite facies:** | The set of metamorphic mineral assemblages (facies) which is typical of regional metamorphism between 450-700°C. |
| **Archaean:** | Widely used term for the earliest era of geological time spanning the interval from the formation of Earth to about 2,500 million years ago. |
| **basalt:** | A dark, fine-grained volcanic rock of low silica (<55%) and plagioclase feldspar and pyroxene. |
| **biotite:** | A type of black mica |
| **breccia:** | A rock made up of mainly angular fragments. |
| **carbonate:** | A sediment formed from the organic or inorganic precipitation from aqueous solution of carbonates of calcium, magnesium, or iron; e.g., limestone and dolomite. |
| **chalcopyrite:** | A bright brass-yellow copper-iron sulphide: $CuFeS_2$. |
| **chlorite:** | Family of tetrahedral sheet silicates of iron, magnesium, and aluminum, characteristic of low-grade metamorphism. |
| **craton:** | Large, and usually ancient, stable mass of the Earth's crust. |
| **diamond drilling:** | A method of obtaining a cylindrical core of rock by drilling with a diamond-set or diamond impregnated bit. |
| **dolerite:** | A fine to medium grained intrusive mafic rock |
| **dyke:** | Thin, sheet-like intrusion of magmatic (igneous) rock. |
| **electromagnetic (EM) survey:** | A geophysical survey technique where potential fields are measured under the influence of an applied current. |
| **epigenetic:** | A hydrothermal event imposed upon rocks (usually by the hydrothermal phase of felsic intrusions). |

| | |
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| **facies:** | Changes in composition, mineral associations or crystallisation sequence brought about by different depositional environments, increasing distance from source, or differing physical and chemical parameters. |
| **felsic:** | Light coloured rocks containing an abundance of feldspars and quartz. |
| **ferruginous:** | Containing iron. |
| **foliation:** | The banding or lamination of metamorphic rocks as distinguished from stratification in sedimentary rocks. |
| **gabbro:** | A coarse-grained mafic intrusive rock, which is low in silica and has relatively high levels of iron and magnesium minerals. |
| **granite:** | A coarse-grained igneous rock containing mainly quartz and feldspar minerals and subordinate micas |
| **hydrothermal:** | Hot water associated with thermal springs or felsic intrusive rocks. |
| **igneous:** | Rocks that have solidified from a magma. |
| **JORC:** | The Joint Ore Reserves Committee (Australia). The JORC Code for the classification and reporting of mineral resources and ore reserves has now become an internationally accepted standard. |
| **laterite:** | Red residual soil developed in humid, tropical, and subtropical regions of good drainage. |
| **Ma:** | An abbreviation for 'million years ago'. |
| **mafic:** | Descriptive of rocks composed dominantly of magnesium, iron and calcium-rich rock-forming silicates. |
| **magnetite:** | A naturally occurring magnetic oxide of iron ($Fe_3O_4$) |
| **mantle:** | The zone between the core and crust of the earth |
| **metallogenic:** | Association of metal ores that is peculiar to a particular region, or period of time. |
| **meta-:** | A prefix meaning 'metamorphosed'. |
| **mylonite:** | A compact, chert like rock without cleavage, produced by the extreme granulation and shearing of rocks |

**olivine:** An olive green magnesium-iron silicate $(Mg,Fe)_2SiO_4$, common in mafic and ultramafic igneous rocks.

**orogeny:** Process by which mountain structures develop.

**pegmatite:** An exceptionally coarse-grained igneous rock, with interlocking crystals, usually found as irregular dykes, lenses or veins.

**percussion drilling (RC):** Drilling method employing a repeated hammering action on a drill bit, also known as Reverse Circulation (RC) drilling.

**peridotite:** A general term for ultramafic igneous rocks dominantly consisting of dominant olivine, subordinate clinopyroxene, and lacking feldspar.

**pluton:** A body of igneous rock formed beneath earth surface by consolidation from magma.

**porphyry:** An igneous rock of any composition that contains conspicuous phenocrysts (coarse crystals) in a fine-grained groundmass.

**Precambrian:** All geologic time, and its corresponding rocks, before the beginning of the Palaeozoic (from 570 Ma back).

**Proterozoic:** An era of geological time spanning the period from 2,500 million years to 570 million years before present.

**pyrite:** A very common iron sulphide mineral $FeS_2$.

**pyrrhotite:** A magnetic iron sulphide mineral (complex structure, summary $Fe_7S_8$ formula)

**schist:** A micaceous crystalline metamorphic rock having a foliated structure

**sericite:** A white or pale apple green potassium mica,

**shear:** Deformation resulting from stresses that cause contiguous parts of a body to slide relative to each other in a direction parallel to their plane of contact.

**stratigraphic:** The arrangement of strata.

**strike:** The direction or trend taken by a structural surface.

**stockwork:** A mineral deposit consisting of a three-dimensional network of planar to irregular veinlets closely enough spaced that the whole mass can be mined.

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| **sulphide minerals:** | Mineralisation characterised by compounds of metals and sulphur. |
| **supergene:** | Oxidation, electrolytic and solution effects brought about by low temperature, ground-water activity**.** |
| **syncline:** | A configuration of folded, stratified rocks in which rocks dip downward from opposite directions to come together in a trough**.** |
| **synform:** | A fold whose limbs close downward in strata for which the stratigraphic sequence is unknown. |
| **tectonised:** | Rocks that have been deformed by movement of the crust |
| **thrust:** | An overriding movement of one crustal unit over another. |
| **ultramafic:** | Igneous rock in which more than 90% of the minerals are ferromagnesian minerals. |

**Ernst & Young Transaction Advisory Services Limited**
Ernst & Young Building
11 Mounts Bay Road
Perth WA 6000 Australia
GPO Box M939 Perth WA 6843

Tel: +61 8 9429 2222
Fax: +61 8 9429 2192
www.ey.com/au

THIS FINANCIAL SERVICES GUIDE FORMS PART OF THE INDEPENDENT EXPERT'S REPORT

16 May 2012

# PART 2 - FINANCIAL SERVICES GUIDE

## 1. Ernst & Young Transaction Advisory Services

Ernst & Young Transaction Advisory Services Limited ("Ernst & Young Transaction Advisory Services" or "we," or "us" or "our") has been engaged to provide general financial product advice in the form of an Independent Expert's Report ("Report") in connection with a financial product of another person. The Report is set out in Part 1.

## 2. Financial Services Guide

This Financial Services Guide ("FSG") provides important information to help retail clients make a decision as to their use of the general financial product advice in a Report, information about us, the financial services we offer, our dispute resolution process and how we are remunerated.

## 3. Financial services we offer

We hold an Australian Financial Services Licence which authorises us to provide the following services:

- Financial product advice in relation to securities, derivatives, general insurance, life insurance, managed investments, superannuation, and government debentures, stocks and bonds; and
- Arranging to deal in securities.

## 4. General financial product advice

In our Report we provide general financial product advice. The advice in a Report does not take into account your personal objectives, financial situation or needs.

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## 5. Remuneration for our services

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As the holder of an Australian Financial Services Licence, we are required to have a system for handling complaints from persons to whom we provide financial services. All complaints must be in writing and addressed to the AFS Compliance Manager or Chief Complaints Officer and sent to the address below. We will make every effort to resolve a complaint within 30 days of receiving the complaint. If the complaint has not been satisfactorily dealt with, the complaint can be referred to the Financial Ombudsman Service Limited.

## 9. Compensation Arrangements

The Company and its related entities hold Professional Indemnity insurance for the purpose of compensation should this become relevant. Representatives who have left the Company's employment are covered by our insurances in respect of events occurring during their employment. These arrangements and the level of cover held by the Company satisfy the requirements of Section 912B of the Corporations Act 2001.

| **Contacting Ernst & Young Transaction Advisory Services** | **Contacting the Independent Dispute Resolution Scheme:** |
|---|---|
| AFS Compliance Manager<br>Ernst & Young<br>680 George Street<br>Sydney NSW 2000<br><br>Telephone: (02) 9248 5555 | Financial Ombudsman Service Limited<br>PO Box 3<br>Melbourne VIC 3001 Telephone: 1300 78 08 08 |

This Financial Services Guide has been issued in accordance with ASIC Class Order CO 04/1572.