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Fundamental Research Corp.

Investment Analysis for Intelligent Investors

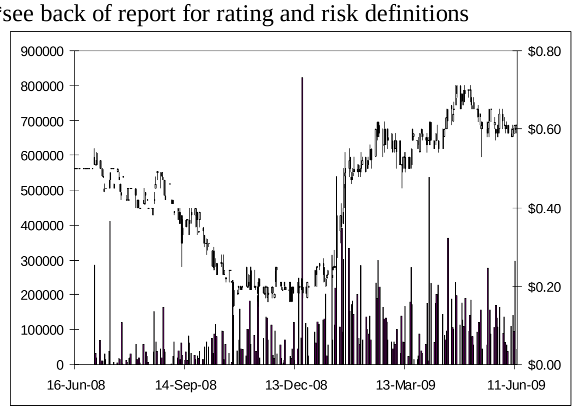
Castle Gold Corporation (TSXV: CSG) – Earnings Exceed Expectation; Development Updates; FINAL REPORT

Sector/Industry: Junior Mining **www.castlegoldcorp.com**

Market Data (as of June 15, 2009)

Current Price	**C$0.59**
Fair Value	**C$1.49 (↓)**
Rating*	**BUY**
Risk*	**4 (Speculative)**
52 Week Range	C$0.15 - C$0.71
Shares O/S	75.31 mm
Market Cap	C$44.43 mm
Current Yield	N/A
P/E (2009E)	8.1x
P/B	1.46x
YoY Return	20.0%
YTD TSXV	-57.1%

*see back of report for rating and risk definitions



Highlights:

- CSG is on track towards producing 50,000 oz of gold per annum by the end of 2009, or early 2010, as the company entered into a new contract arrangement to utilize larger equipment fleets with the goal of achieving such production rate. CSG expects operating costs to fall by $25/oz upon achieving the targeted production rate.
- In late April 2009, portions of a new equipment fleet commenced operations, this is expected to increase the mining rate to 600,000 tonnes per month (ores plus waste) as compared to the average rate of 503,300 tpm in Q1 2009.
- Operating expenses at the El Castillo mine fell significantly to $520/oz in Q4 2008, and further to $502/oz in Q1 2009, compared to $685/oz in Q3 2008, as the waste to ore ratio declined. The strip ratio is expected to stay at Q1 2009 levels through 2009.
- To further reduce operating costs at El Castillo, the company intends to invest about $1 million in a portable screening deck, which is expected to reduce operating expenses by $34/oz.
- The company completed a resource estimate in the transition/sulphide zone of the El Castillo mine (non NI 43-101) including 27.9 million tonnes at an average grade of 0.7 gpt containing a total of 624,712 oz gold in the inferred category.
- The first phase of a reverse circulation drill program aimed at expanding the oxide gold mineralization at the El Castillo mine had encouraging results.
- In 2008, the company posted net income of $1.85 million (EPS: $0.02), compared to a net loss of $1.52 million (EPS: -$0.03) in 2007, and exceeded our forecast of $0.49 million (EPS: $0.01). In Q1 2009, the company posted net income of $0.68 million (EPS: $0.01).
- Production at El Sastre is expected to wind down in 2009, due to the depletion of reserves.
- We reiterate our BUY rating but lower our fair value estimate from C$1.67 per share to C$1.49 per share, as we lowered our valuation on the El Sastre and La Fortuna properties.

Note: All figure in this report are in US$ unless otherwise stated.

Key Financial Data (FYE - Dec 31) (US$)	2007	2008	2009E	2010E
Revenues	7,831,966	14,018,066	32,634,107	43,163,893
Net Income	(1,520,053)	1,845,936	5,505,023	10,939,947
EPS	(0.03)	0.02	0.07	0.15
Cash + Marketable Securities	1,415,491	2,196,406	6,541,072	18,625,155
Working Capital	1,775,414	6,527,178	13,005,186	25,967,213
Mineral Assets & PPE	39,340,141	34,675,383	34,109,773	32,495,069
Total Assets	43,329,923	44,165,062	49,442,981	60,857,038

Castle Gold is producing from the 100% owned El Castillo Gold Mine in Durango, Mexico and the 50% owned El Sastre Mine in Guatemala. The company's strategy, pioneered by experienced management, is to start with small, low cost heap leaching operations, build resources and grow production out of cash flow.

Revenues Inline With Expectations

In 2008, the company reported revenues of $14.02 million, in line with our expectation of $14.62 million, compared to $7.83 million in 2007. In Q1 2009, CSG posted revenues of $5.91 million, compared to $1.61 million in Q1 2008, primarily due to commercial production from the El Castillo mine since July 2008. Particularly, in Q1 2009, the company produced 5,968 oz of gold from the El Castillo mine (average grade 0.57 g/tonne), which is almost inline with the company's goal of producing 25,000 to 30,000 oz of gold per annum as discussed in our previous report.

In addition, we are also pleased to see the company is moving forward toward its eventual goal of producing 50,000 oz of gold by the end of the year. Subsequent to 2008 (and as we predicted in our previous report), the company entered into a new contract arrangement with its existing mine contractor to utilize larger equipment fleets with the goal of achieving a production rate of 50,000 ounces or greater, by the end of 2009, or early 2010. In late April 2009, portions of a new equipment fleet commenced operations, which is expected to increase the mining rate by 28%, to 600,000 tonnes per month (ores plus waste), compared to the average rate in Q4 2008.

Production at the El Sastre mine was 1,660 oz in Q1 2009. CSG expects to wind down their primary mining activities at the El Sastre late in Q2 2009. After the discontinuation of mining operations, crushing operations on existing coarse ore stockpiles will continue at El Sastre until late 2009, with site leaching operations projected to continue into 2010. Based on our discussion with management, the company decided to discontinue mining at El Sastre because of the depletion of reserves at the mine. Note that in our previous report, we had valued the El Sastre mine based on the resource estimate defined by the company and its joint venture partners for the project, which had indicated a mine life through 2013. However, management's decision to discontinue operations, we believe, indicates lower confidence in the previously calculated resource estimates, and therefore, we have lowered our valuation on the project. Our revised valuation only accounts for the value from the remaining production in 2009 and 2010.

Revenue Forecast: We forecast the company will produce 33,867 oz (previous forecast 33,125 oz) and 50,000 oz of gold from the El Castillo mine, and 2,604 (previous forecast 10,318 oz) and 781 oz of gold from the El Sastre mine, in 2009, and 2010, respectively. Note that as the company has not given production guidance for its El Sastre mine in 2009, and 2010, our production forecasts for the mine are based on available information at this time. Overall, in 2009, we forecast revenues of $32.63 million, down from our previous forecast of $38.45 million (primarily due to the revised production outlook for El Sastre). In 2010, we forecast revenues of $43.16 million. We have not made any changes to our outlook on gold prices. Revenue forecasts were based on gold prices of US$900/oz in 2009, and US$850/oz in 2010.

Operating Expenses Reduced

Operating expenses at the El Castillo mine fell significantly to $520/oz in Q4 '08, and $502/oz in Q1 '09, compared to $685/oz in Q3 '08. The reduction, we believe, was due to a lower strip ratio of 1.32 in Q1 '09, down from over 1.50 in Q3 '08. The company expects the strip ratio to be in the range of 1.2 to 1.3, for the balance of 2009. CSG forecasts the waste to ore ratio to decline towards the LOM average of 0.6 by the second half of the 2010.

In addition, we believe, the company has potential to further cut costs in the following two areas:

- Under the new contract arrangement to utilize larger equipment fleets (discussed above) and at the expanded mining rate of 800,000 tonnes per month, operating expenses are expected to fall by $25/oz. We have accounted for this in our valuation model.
- Based on an internal study, the company intends to invest about $1 million in a portable screening deck, which can screen out fine fractions (less than ¾ inch) of the high-grade ore (the fine fraction accounts for a large percentage of the high grade ore) so that it can bypass the existing crushing equipment and be stacked directly on the heap leach pads. This is expected to reduce operating expenses by $34/oz. In our valuation models, we have accounted for this by assuming the company will invest $1 million in late 2009, with a reduction in operating costs starting 2010.

We have estimated operating expenses of $482/oz and $390/oz for the remaining 9 months of 2009, and 2010, respectively, in our valuation models for the El Castillo mine. This compares to our previous operating cost estimates of $490/oz and $402/oz, respectively.

At the El Sastre mine, operating expenses averaged $234/oz in Q1 2009, unchanged from that in Q1 2008, but higher than our expectation of $200/oz for 2009. The increasing in operating costs, we believe, was attributable to the depleting ore reserves. We have thus revised our operating cost estimates to $251/oz for the El Sastre mine in 2009, and 2010.

EPS Exceeds Expectations

In 2008, the company posted net income of $1.85 million (EPS: $0.02), exceeding our forecast of net income of $0.49 million (EPS: $0.01), compared to a net loss of $1.52 million (EPS: -$0.03) in 2007. In Q1 2009, the company reported net income of $0.68 million (EPS: $0.01), compared to $0.76 million (EPS: $0.01) in Q1 2008. The company also recorded considerably higher than expected amortization expenses as they started commercial production from the El Castillo mine in July 2008. We have adjusted our models accordingly. **Given all the changes discussed above, we have revised our earnings forecast from $8.81 million (EPS: $0.12), to $5.51 million (EPS: $0.07), in 2009. In 2010, we forecast net income of $10.94 million (EPS: $0.15).**

Stock Options and Warrants

At the end of Q1 2009 (ended March 2009), the company had 6.99 million stock options outstanding with exercise prices ranging from C$0.24 to C$1.02, and maturity periods between 1.46 to 4.29 years (5.94 million options are currently 'in the money'). The company also had 0.05 million warrants outstanding with an exercise price of C$0.54.

Cash Flows and Liquidity

At the end of Q1 2009, the company had $1.71 million in cash (including marketable securities). Based on a capital expenditure forecast of $2.59 million in 2009 (including a $1 million investment to reduce operating costs as discussed earlier), we believe cash from operations will be sufficient to fund capital expenditures, and therefore, we do not foresee a need for any external financing in 2009.

EL Castillo Development Updates

Resource Study Since our last report, the company released results of a study on the mineral resources contained within the Transition Zone and the Sulphide Zone of mineralization that exists below the oxide reserves at the El Castillo open pit mine. Based on the study, the Transition/Sulphide Zone includes 27.9 million tonnes at an average grade of 0.7 g/tonne gold containing a total of 624,712 ounces of gold (shown in the following table) in the inferred category. This resource was calculated at a cut-off grade of 0.5 g/tonne gold and based on the historic database of 211 reverse circulation and diamond drill holes drilled beyond the depths of the oxide material (beyond 100 m) to an average depth of approximately 230m. We note the resource estimate is not NI 43-101 compliant, and the company intends to complete a NI 43-101 compliant resource after incorporating metallurgical work on the Transition and Sulphide zones (current metallurgical test results are discussed below).

TRANSITION ZONE INFERRED RESOURCES			
Cut off Grade	Tonnes	Grade	Contained Gold
(gpt)	(000's)	(gpt)	(ounces)
0.40	18,857	0.61	372,561
0.50	11,071	0.73	261,479
0.60	6,853	0.85	188,160
0.70	3,967	1.00	128,007
SULPHIDE ZONE INFERRED RESOURCES			
Cut off Grade	**Cut off Grade**	**Grade**	**Contained Gold**
(gpt)	(000's)	(gpt)	(ounces)
0.40	30,045	0.57	551,765
0.50	16,818	0.67	363,233
0.60	10,070	0.76	244,954
0.70	5,116	0.86	140,830
COMBINED TRANSITION-SULPHIDE ZONE INFERRED RESOURCES			
Cut off Grade	**Cut off Grade**	**Grade**	**Contained Gold**
(gpt)	(000's)	(gpt)	(ounces)
0.40	48,903	0.59	924,326
0.50	27,889	0.70	624,712
0.60	16,923	0.80	433,114
0.70	9,083	0.92	268,837

Source: Company

Metallurgical Test: Subsequently, SGS Mineral Services conducted metallurgical tests on four separate sections of quartered drill core from two diamond drill holes (one sample from the Transition zone and three samples from the Sulphide zone). The samples were subjected to both conventional bottle roll and coarse ore bottle rolls to simulate heap leaching conditions, with sample head grades averaging from 0.53 g/tonne gold to 1.15 g/tonne gold. Coarse ore cyanide bottle roll testing of one sample from the Transition zone resulted in gold recoveries of 75.5% to 79.9%, following 21 days of leaching (¾ inch to ¼ inch crush sizes). Coarse ore testing of samples from the Sulphide zone suggested recoveries as high as 42.8% for one sample, to as low as 8.3% (at ¾ inch to ¼ inch crush sizes) following 21 days of leaching.

Drilling Program at El Castillo

In April 2009, the company began the first phase of a reverse circulation drill program aimed at expanding the oxide gold mineralization at the El Castillo mine. The drilling program is focused on testing areas to the south and to the east of the El Castillo pit, where historic drilling on the deposit by Battle Mountain Gold, recent geological mapping, and a historical geochemical survey indicated good potential to discover additional gold mineralization.

Subsequently, the company released assay results from the 19 hole phase I drilling program. Gold mineralization was intersected in the majority of holes drilled with gold grades above the resource cut-off grade of 0.15 g/tonne used to calculate the El Castillo mine gold resource and reserve, and comparable to, or better than, the historic assay results in the vicinity of these Phase 1 drill holes. The best results came from the following two holes.

- Hole CA – 216 intersected 109.7 m grading 0.70 g/tonne gold from 16.8 m to 126.5 m, including 65.5 m grading 1.02 g/tonne gold from 61.0 metres to 126.5 metres.
- Hole CA – 231 intersected 42.7 m grading 0.72 g/tonne gold from 54.9 m to 97.5 m.

The company is currently planning a second phase of drilling intended to better define the extent of these new mineralized areas from the phase I drilling program.

Valuation

Given the changes discussed above, our revised valuation of the El Castillo Mine is C$90.86 million (C$1.18 per share), compared to C$89.71 million (C$1.19 per share) in our previous report. Note that we have incorporated half of the newly defined gold resource (i.e. 0.31 million oz) for the transitional/sulphide zone, and increased capital costs by C$10 million to develop the potential resources. We have also reduced the discount rate from 12.84% in our previous report, to 11.50%, as the El Castillo mine has commenced commercial production.

DCF Valuation Summary - El Castillo Mine	
Ownership	100%
Mineral Resources Oxide Zone (in tonnes)	96,550,000
Gold Grade (gpt) - Oxide Zone	0.788
Mineral Resources Transitional/Sulfide Zone (in tonnes)	27,900,000
Gold Grade (gpt) - Transitional/Sulfide Zone	0.70
Remaining Gold Recovered (in troy oz)	980,204
Recovery - Oxide Zone	68%
Recovery - Transitional/Sulfide Zone	60%
Mine Life (years)	20
Long-term Gold Price ($/oz)	600
Capital Costs (C$)	$13,189,104
LT Operating & Admin costs (C$/oz)	$385.00
ST Operating & Admin costs ($/oz)	Remaining 9 Mo in 2009: $482/oz; 2010: $390/oz
Discount rate	11.50%
Net Present Value (C$)	**$90,857,964**
No. of Shares (Diluted)	76,868,914
Fair Value (C$/Share)	**$1.18**

Sensitivity of El Castillo: The following table shows the sensitivity of our DCF valuation of the El Castillo project to our long term gold price forecast.

Gold Price ($/oz)	Valuation (C$/Share)
500	0.88
600	**1.18**
700	1.49
800	1.79
900	2.10
1000	2.40

As the company plans to discontinue mining at the El Sastre mine, we have only valued it based on our production forecast discussed earlier (2,604 oz and 781 oz mine in 2009, and 2010, respectively). Our valuation dropped from C$0.17 per share, to C$0.01 per share as a result.

For the La Fortuna project, our revised valuation is $0.26 per share, compared to $0.36 per share in our previous report. Our valuation dropped as we delayed production commencement estimates by one year (from 2011 to 2012), and due to share dilution.

Overall, our revised valuation on the company is C$1.49 per share, down from C$1.67 per share in our previous report.

Valuation Summary		
El Castillo	$90,923,994	$1.18
El Sastre	$949,954	$0.01
La Fortuna	$20,084,421	$0.26
Working Capital net Debt	$2,728,222	$0.04
Net Value	**$114,686,591**	**$1.49**

Conclusions & Rating

We were pleased to see that the company has made good progress in increasing production, and reducing operating costs, at its El Castillo mine. Based on our review of the company's progress since our previous report, and our revised valuation models, we reiterate our BUY rating on CSG, but lower our fair value estimate from C$1.67 per share to C$1.49 per share.

Risks

We continue to rate the shares a **RISK of 4 (Speculative).** The following risks, though not exhaustive, will cause our estimates to differ from actual results:

- Like other producing companies, the value of the company depends heavily on gold prices.
- The company may experience operating issues from its El Castillo mine, which recently achieved commercial production.
- The success of further development, exploration, and expansion is a significant factor in Castle Gold's success.

Appendix: Financial Statements

Castle Gold Corporation - Income Statement
(in US$)

	2007	2008	2009E	2010E
Revenues	**7,831,966**	**14,018,066**	**32,634,107**	**43,163,893**
Cost of Sales	1,977,835	7,702,601	16,742,146	19,691,751
Gross Margins	**5,854,131**	**6,315,465**	**15,891,962**	**23,472,142**
Expenses				
General and Administrative	1,754,790	3,911,153	4,084,168	4,206,693
Exploration Expenses	433,247	267,637	294,401	323,841
Impairment charges	1,076,986	61,140	-	-
EBITDA	**2,589,108**	**2,075,535**	**11,513,393**	**18,941,608**
Depreciation, Amortization and Accretion	976,400	1,833,393	3,151,082	3,114,704
EBIT	**1,612,708**	**242,142**	**8,362,311**	**15,826,904**
Other Income	(636,474)	804,869	(716,447)	(632,534)
Non-controlling Interest	(2,054,951)	-	-	-
Income Taxes	(441,336)	798,923	(2,140,842)	(4,254,424)
Net Income	**(1,520,053)**	**1,845,936**	**5,505,023**	**10,939,947**
EPS	(0.03)	0.02	0.07	0.15

Castle Gold Corporation - Balance Sheets
(in US$)

	2007	2008	2009E	2010E
Assets				
Current Assets				
Cash and cash equivalents	1,162,491	2,186,118	6,530,784	18,614,867
Marketable securities	253,000	10,288	10,288	10,288
Accounts receivables	1,302,256	1,096,969	1,316,363	1,513,817
Inventory	1,130,905	6,056,393	7,267,672	7,994,439
Prepaid expenses	135,686	136,380	204,570	225,027
	3,984,338	**9,486,148**	**15,329,676**	**28,358,438**
Mineral properties, plant and equipment	39,340,141	34,675,383	34,109,773	32,495,069
Other assets	5,444	3,531	3,531	3,531
	43,329,923	**44,165,062**	**49,442,981**	**60,857,038**
Liabilities				
Current Liabilities				
Current portion of mineral property obligation	150,000	100,000	100,000	100,000
Current portion of long-term debt	858,984	699,271	-	-
Accounts payable and accrued liabilities	1,199,940	2,159,699	2,224,490	2,291,225
	2,208,924	**2,958,970**	**2,324,490**	**2,391,225**
Long-term debt	6,550,985	5,271,117	5,271,117	5,271,117
Provision for site closure and reclamation obligations	482,169	433,763	433,763	433,763
Future income taxes	7,133,000	5,878,000	5,878,000	5,878,000
Other long-term liabilities	100,000	-	-	-
	16,475,078	**14,541,850**	**13,907,370**	**13,974,105**
Non-controlling interest	-	-	-	-
Shareholders' Equity				
Share Capital	32,512,750	33,090,998	33,090,998	33,090,998
Contributed Surplus	1,858,567	2,494,718	2,902,094	3,309,470
Other	(65,703)	(357,671)	(357,671)	(357,671)
Retained Earning	(7,450,769)	(5,604,833)	(99,810)	10,840,136
	26,854,845	**29,623,212**	**35,535,611**	**46,882,933**
Total Liabilities and S.E	**43,329,923**	**44,165,062**	**49,442,981**	**60,857,038**

Castle Gold Corporation - Cash Flows
(in US$)

	2007	2008	2009E	2010E
Operating Activities				
Net Income	**(1,520,053)**	**1,845,936**	**5,505,023**	**10,939,947**
Non-Cash Items:				
Depreciation, depletion and accretion	976,400	1,833,393	3,151,082	3,114,704
Non-controlling interest	2,054,951	-	-	-
Unrealized foreign exchange loss	120,790	(1,420,999)		
Impairment charges	1,076,986			
Future tax recovery		(1,255,000)		
Change in fair value of marketable securities		224,130		
Others		61,140		
Stock Based Compensation	638,833	407,376	407,376	407,376
	3,347,907	**1,695,976**	**9,063,480**	**14,462,027**
Change in Non-Cash Working Capital Items:				
Accounts Receivable	(584,497)	205,287	(219,394)	(197,454)
Inventory	(1,230,372)	(4,050,515)	(1,211,279)	(726,767)
Prepaid Expenses and Deposits	(131,510)	(694)	(68,190)	(20,457)
Accounts Payable and Accrued Liabilities	194,540	1,630,786	64,791	66,735
Other	(1,869)	1,913		
	(1,753,708)	**(2,213,223)**	**(1,434,071)**	**(877,944)**
	1,594,199	**(517,247)**	**7,629,409**	**13,584,083**
Financing Activities				
Debt			(699,271)	-
Equity	2,277,784	515,055		
	2,277,784	**515,055**	**(699,271)**	**-**
Investing Activities				
Additions to mineral properties, plant and equi[	(2,687,136)	1,175,819	(2,585,472)	(1,500,000)
Mineral assets				
Capitalized revenues				
Repayment of mineral property obligation		(150,000)		
Cash acquired through amalgamation	183,537			
Deconsolidation	(858,107)			
	(3,361,706)	**1,025,819**	**(2,585,472)**	**(1,500,000)**
Increase(decrease) in Cash	**510,277**	**1,023,627**	**4,344,666**	**12,084,083**

Fundamental Research Corp. Equity Rating Scale:
Buy – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk
Hold – Annual expected rate of return is between 5% and 12%
Sell – Annual expected rate of return is below 5% or the expected return is not commensurate with risk
Suspended or Rating N/A— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

Fundamental Research Corp. Risk Rating Scale:
1 (Low Risk) - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

2 (Below Average Risk) - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

3 (Average Risk) - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

4 (Speculative) - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

5 (Highly Speculative) - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.

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