

## Scaling-up resources

### Investment Highlights

- **Dragon Mining Ltd (DRA) is a Scandinavia-focussed junior gold producer with a pipeline of projects in Sweden and Finland. The company is cash flow positive with three high-grade mines, is leveraged to a strengthening gold price and is fully funded for exploration. We view forthcoming exploration results and a commitment by DRA to develop its underground resources as providing key catalysts in 4Q CY10.**
- **Established producer.** DRA is targeting group production of circa 70,000oz in 2010 from three main operations. This includes Svartliden in Sweden (40,000oz) and Orivesi and Jokisivu (Vamalla production centre 30,000oz) in Finland. DRA's total gold resource inventory contains 981,900oz, of which Svartliden and Vammala account for 185,200oz and 617,900oz, respectively.
- **Svartliden development.** The feasibility study on the underground development at Svartliden is advancing and a decision to commence underground operations is expected later this month. DRA is aiming to increase the resources at Svartliden to 250,000oz by March/April CY11 and has earmarked \$2.5m for extension drilling at Svartliden over the next 12 months to reach this target.
- **Resource to Reserve conversion pending.** DRA aims to lift group gold production to more than 100,000oz p.a. by 2013 through organic growth and will continue to assess potential project acquisitions. We note DRA has potential to discover additional resources in close proximity to Svartliden, having identified more than 30 areas of interest and multiple targets within 5-10km of the existing processing facility.
- **Catalysts.** (1) Drilling results from Svartliden in September, (2) commitment to develop the UG at Svartliden and Jokisivu in September/October, (3) resource update for Svartliden in October.
- **Risks.** (1) Resource to reserve conversion risk, (2), environmental risk at Kaapelinkulma, (3) conventional feasibility risk.

7 September 2010

12mth Rating

SPEC BUY

Price	A\$	0.13
Target Price	A\$	0.21
12m Total Return	%	68.7

RIC: DRA.AX

BBG: DRA AU

Shares o/s	m	743.7
Free Float	%	
Market Cap.	A\$m	93.0
Net Debt (Cash)	A\$m	-22.2
Net Debt/Equity	%	na
3m Av. D. T'over	A\$m	0.12
52wk High/Low	A\$	0.13/0.07
2yr adj. beta		0.98

**Valuation:**

Methodology		DCF
Value per share	A\$	0.21

**Analyst:**

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Gary Watson

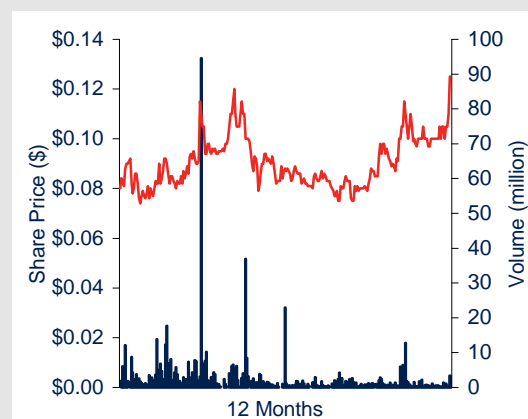
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### 12 Month Share Price Performance



Performance %	1mth	3mth	12mth
Absolute	8.2	31.3	75.0
Rel. S&P/ASX 300	5.6	29.4	83.9

Year End June 30	2010A	2011F	2012F	2013F	2014F
Reported NPAT (\$m)	40.8	34.9	42.9	47.2	26.7
Recurrent NPAT (\$m)	34.7	28.9	34.9	37.2	14.7
Recurrent EPS (cents)	4.7	3.9	4.7	5.0	2.0
EPS Growth (%)	106.8	(16.8)	21.0	6.6	(60.5)
PER (x)	2.7	3.2	2.7	2.5	6.3
EBITDA (\$m)	42.6	37.2	45.9	59.3	17.8
EV/EBITDA (x)	1.7	1.2	0.2	(0.5)	(1.8)
Capex (\$m)	3.5	3.5	3.6	3.7	3.0
Free Cashflow	42.7	35.1	46.3	52.3	25.0
FCFPS (cents)	5.7	4.7	6.2	7.0	3.4
PFCF (x)	2.2	2.6	2.0	1.8	3.7
DPS (cents)	0.0	0.0	0.0	0.0	0.0
Yield (%)	0.0	0.0	0.0	0.0	0.0
Franking (%)	0.0	0.0	0.0	0.0	0.0

## Background

Dragon Mining Ltd (DRA) acquired the Svartliden gold project in Sweden (700km north of Stockholm) when it merged with Canadian-listed Viking Gold Corp in 1999. Viking had drilled 800m of strike length at Svartliden and estimated a total resource of 2.5Mt at 5.4g/t Au for 434,000oz (cut-off 1/gt Au), although no mining had taken place.

Following extensive drilling by DRA at Svartliden, the company moved to cement its foothold in Scandinavia by purchasing additional gold assets in Finland from Outokumpu Mining Oy in November 2003 (€11m cash and scrip deal). The assets included undeveloped resources and exploration prospects as well as developed mines and processing facilities (Figure 1).

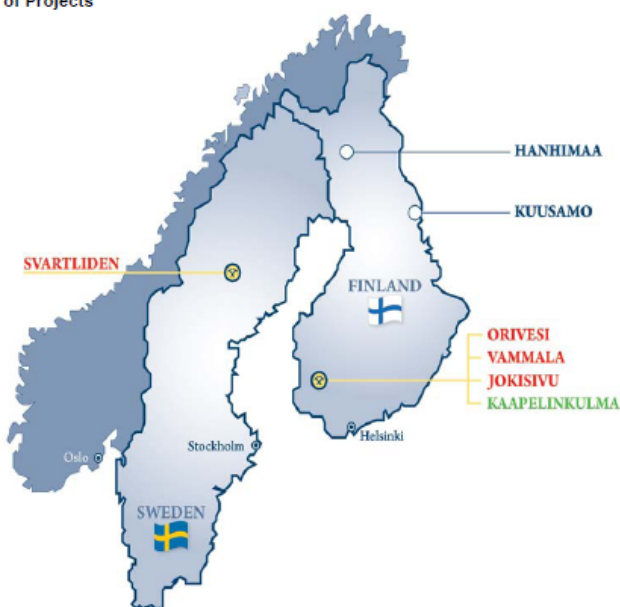
In November 2004, DRA commenced gold production at the Svartliden open pit mine. Until the end of 2009, 1.49Mt of ore was treated from the Svartliden pit at an average head grade of 4.87g/t Au. This included production of 211,000oz of gold at an average cash cost of US\$472/oz.

In July 2007, DRA commenced production at the Orivesi mine in Finland, followed by production at Jokisivu in September 2009. DRA is now well placed to delineate additional resources in Sweden and Finland, with a pipeline of growth assets including the Kaapelinkulma and Kuusamo projects. There are no mining royalties in Sweden or Finland and the corporate tax rates are 26.3% and 26% respectively.

In the June Quarter CY10, DRA produced a total of 20,792oz of gold at an average cash cost of US\$565/oz. We note that DRA's average cost of production is expected to remain below US\$600/oz for the remainder of CY10.

**Figure 1: DRA project location map**

Location of Projects



Source: DRA

## Capital Structure

DRA has 737.6m shares on issue and 6.1m options which are exercisable at \$0.14 to \$0.21. The company has a \$5.8m convertible note liability due in February 2011 and has elected to redeem this liability in the September Quarter (price \$1.05). This note carried a 10% annual coupon paid quarterly and was convertible into six shares.

DRA is fully funded for exploration with estimated cash of \$16m at the end of June and \$14.9 m in gold bullion and concentrate receivables. DRA has gross carried forward tax losses of \$44m at 31 December 2009, which are available to be offset against future taxable income in Sweden, Finland and Australia.

Substantial shareholders include Nicolas Mathys (17.7%) and AIM-listed Brinkley Mining (13.3%).

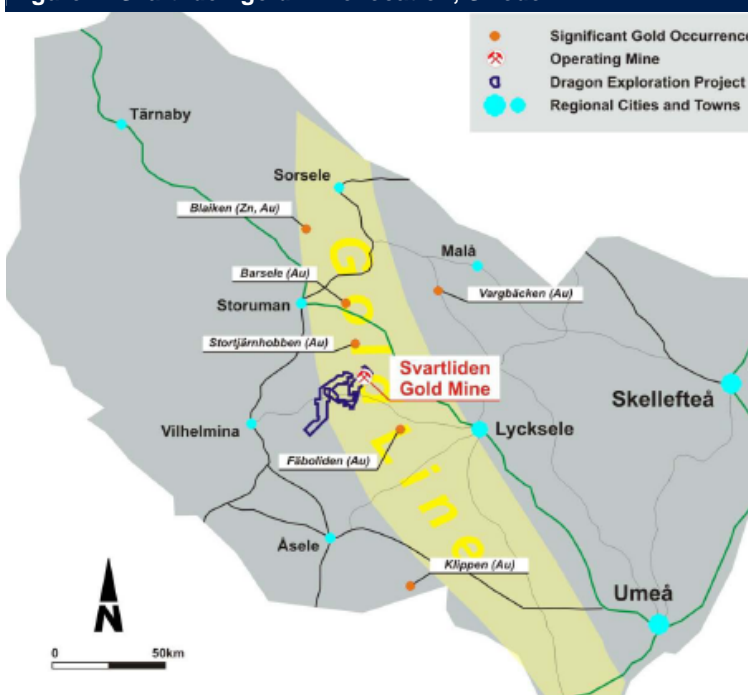
## Svartliden – Extending resources

DRA has produced 230,000oz of gold from the Svartliden pit since 2005 and is currently generating cash in excess of US\$20m per year from the mine. DRA expects the operation to produce circa 40,000oz of gold in 2010. A commitment to develop the underground (expected in the September Quarter) would increase the mine life to more than two years.

We note that the underground resources at Svartliden (312,000t at 7.1g/t Au for 71,000oz) may represent a fraction of the actual size of the deposit. The resource remains open at depth and exploration along strike has identified the continuation of mineralisation (see below). The open pit resource includes 894,000t at 3.2g/t Au for 92,000oz of gold.

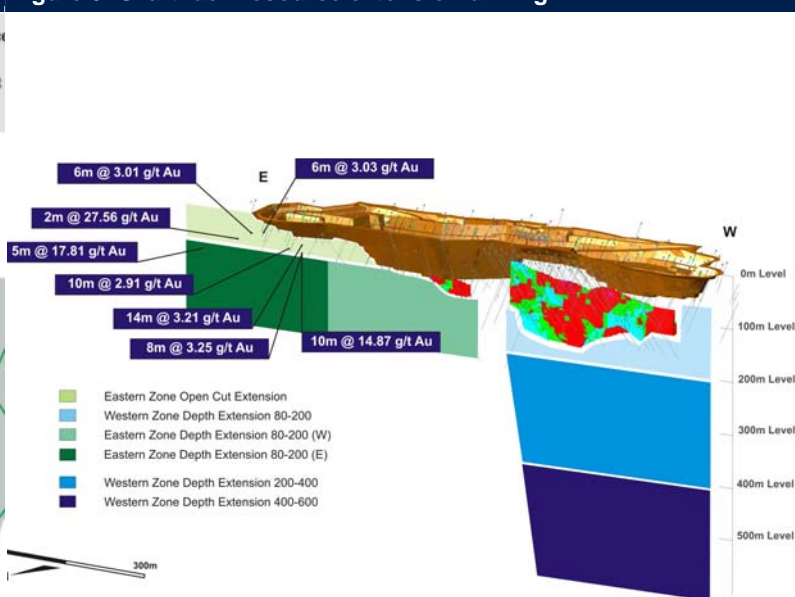
The company has spent \$25m on construction of a new mill (300,000tpa CIL treatment plant) and is now confident of achieving optimal recoveries of circa 93%. An extra leach tank will also be incorporated this year at a cost of \$0.3m to further increase recoveries.

Figure 2: Svartliden gold mine location, Sweden



Source: DRA

Figure 3: Svartliden resource extension drilling



Source: DRA

## Resource update pending

DRA recently completed a 32-hole (4,525m) diamond drilling programme at the Eastern Zone Open Cut Extension, which returned several drilling highlights. This included 10m at 14.87g/t Au, 2m at 27.56g/t Au, 14m at 3.21g/t Au, 8m at 3.25g/t Au and 10m at 2.91g/t Au. These results will form part of an updated resource estimate for Svartliden by the end of the September Quarter.

Two diamond drill rigs are now on site to complete a 25-hole (4,645m) Western Zone Depth Extension campaign which will test the western portion of the Svartliden deposit below and adjacent to the existing underground Indicated (259,000t at 7.2 g/t gold) and Inferred (53,000t at 7.1 g/t gold) Resource. Initial results from the latest drilling campaign are expected in October. We anticipate a strengthening gold price will support a decision to commence underground mining at Svartliden. DRA intends to complete 22,000m of diamond drilling at Svartliden over the next 12 months at a cost of \$2.5m.

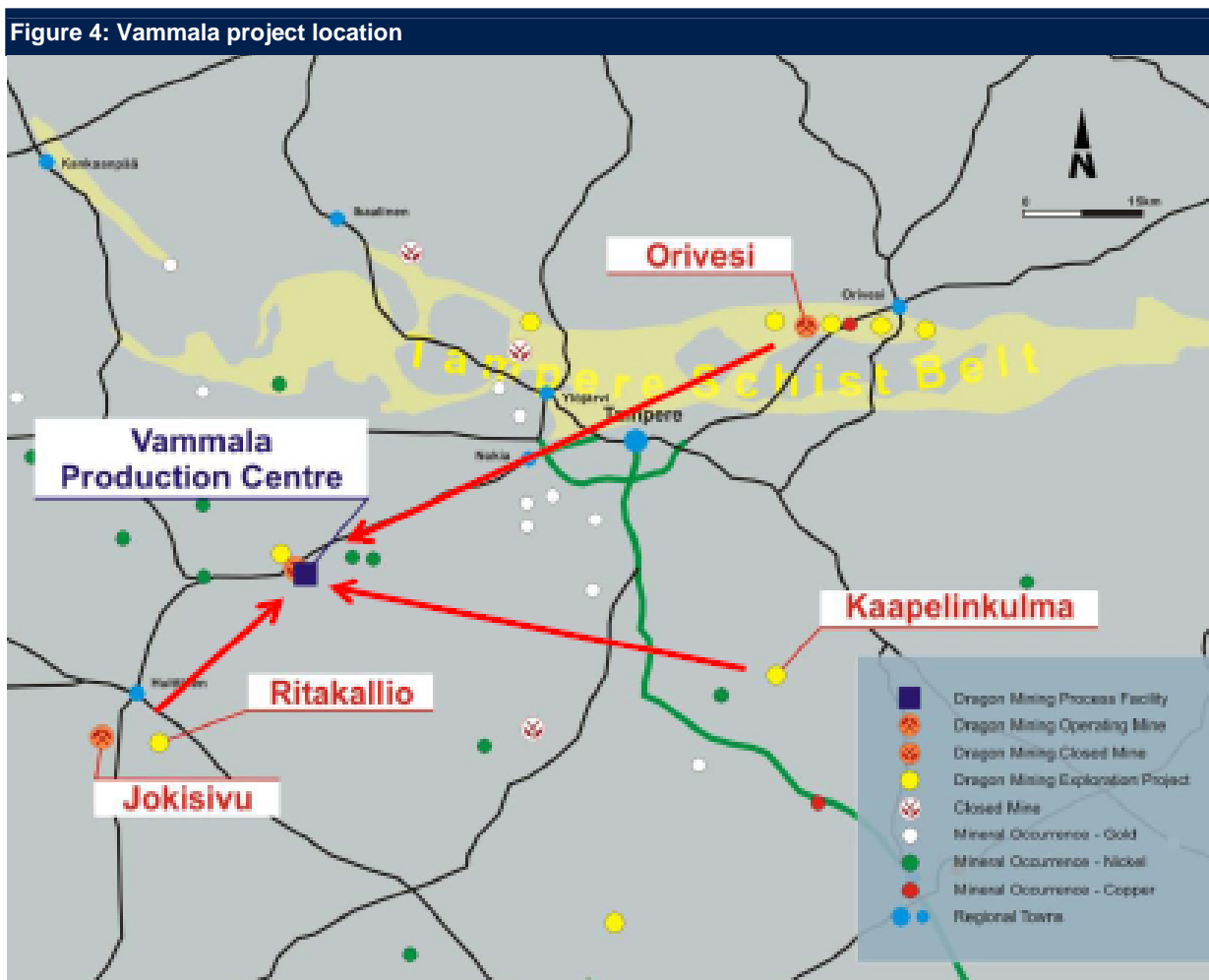
## Targeting growth in Finland

DRA acquired the Finnish precious metals assets from Outokumpu Mining Oy in 2003. The asset sale was not a reflection of a lack of confidence by Outokumpu in the potential to develop the assets, but rather part of the company's strategic move out of mining altogether. The acquisition has allowed DRA to develop a pipeline of growth projects to support existing production at the Vammala treatment facility.

## Vammala Production Centre

The Vammala production centre in southern Finland includes a 320,000tpa crushing, milling and flotation facility for gold which services the Jokisivu and Orivesi mines and is less than 40km and 80km trucking distance from the two mines, respectively. The total resource inventory for Vammala, which also includes the Kaapelinkulma development project, stands at 3.15Mt at 6.1g/t Au for 617,900oz of gold.

The Vammala plant was recommissioned in June 2007 and current gold recoveries are generally over 84%. Jokisivu and Orivesi are the two main mines, although DRA is working diligently to assess the potential of Kaapelinkulma for an additional source of ore. Concentrate at Vammala is refined at the Boliden Harjavalta smelter an average cost of US\$100/oz.



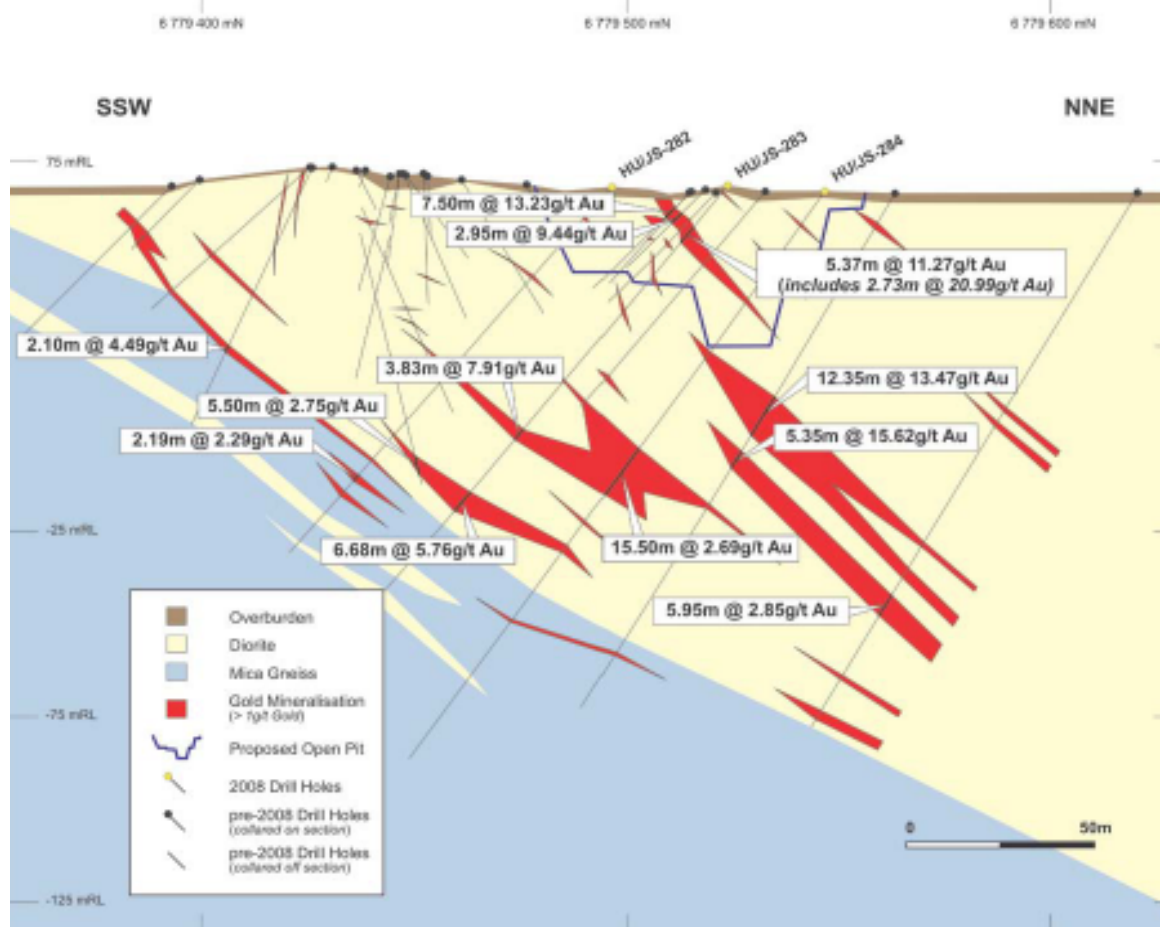
Source: DRA

## Jokisivu – Heading underground

The Jokisivu mine, located 40km from the Vammala production centre, represents an opportunity for DRA to mine high-grade underground ore in parallel with production from Orivesi. The company intends to produce 10,000oz from the Jokisivu open pit this year with a view to increasing production to 30,000oz of gold in 2013, following commencement of underground production. We anticipate DRA will commit to development of the underground portal at Jokisivu in 4Q CY10.

Jokisivu was still under exploration drilling when DRA acquired it in 2003. Today, the total resource at Jokisivu contains 1.782Mt at 6.2g/t Au for 356,300oz of gold (includes Arpola and Kujankallio deposits). The Arpola deposit contains 0.44Mt at 6.7g/t Au for 94,400oz of gold and the Kujankallio deposit contains a total of 1.341Mt at 6.1g/t Au for 261,900oz of gold.

**Figure 5: Jokisivu project**



Source: DRA

## Orivesi – Exploring depth potential

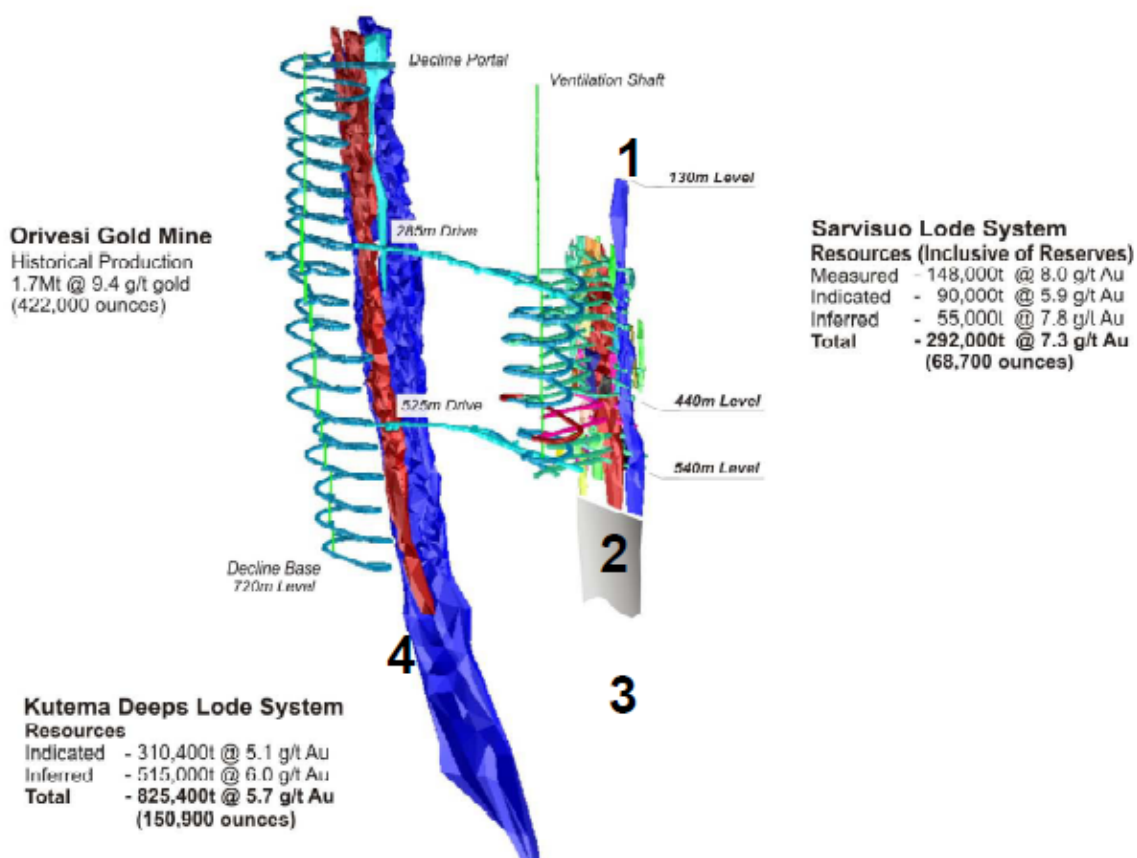
Historically, Orivesi has been the main source of high-grade ore for the Vammala treatment plant. In the 1980's the discovery of the Kutema lode system presented five clustered near-vertical pipes which were mined individually. Up until 2003, 422,000oz were recovered from 1.7Mt of Kutema ore at an average grade of 9.4g/t Au. Notably, two of the pipes are known to continue below the decline base at 720m.

The deposit was mined to 720m before the Outokumpu decision to withdraw from mining brought production to a halt. When DRA acquired the operation in 2003, the company preserved access to the decline for further drilling. DRA plans to spend \$1.5m exploring for new pipes at Kutema this year.

The company has also sharpened its focus on the Sarvisuo lode system (see below) with a view to continuing the decline from 540m down to the 620 level in 2011. Mineralisation remains open along strike and at depth. DRA estimates there is 12 months left of reserves with an average grade of 7.0g/t Au. Ongoing drilling is aimed at replenishing reserves and historically DRA has shown it can replenish its reserves as it mines deeper.

The first development ore was delivered from Orivesi to Vammala in July 2007. The company currently produces 20,000ozpa and development at Kutema Deeps is expected to add to add 10,000oz.

**Figure 6: Orivesi underground resources**



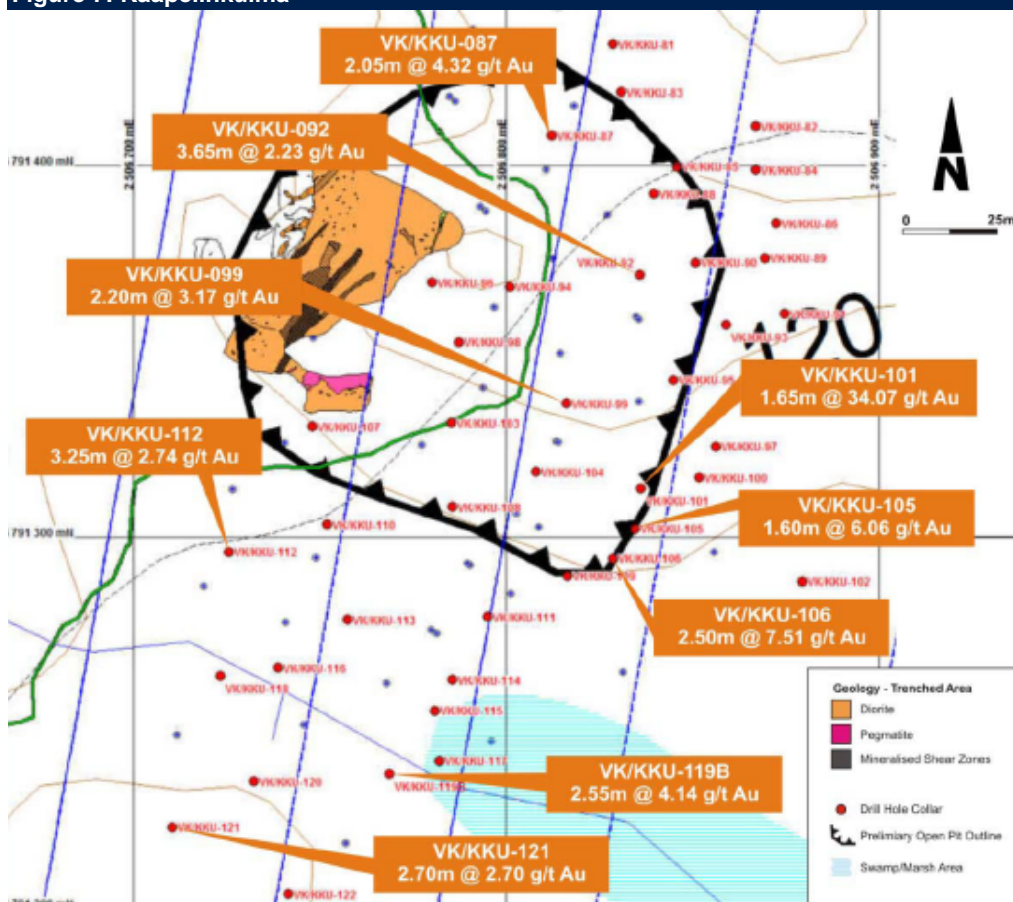
Source: DRA

## Development opportunities - Kaapelinkulma

The Kaapelinkulma project, located 60km east of Vammala, is emerging as a third potential source of ore for the Vammala treatment plant. The deposit remains open down plunge and along strike and represents potential for an additional source of feed during underground production in 2012. We note that the resource has only been drilled to a maximum depth of 50m and potential exists for DRA to develop deeper resources for a potential underground mining operation.

A recently completed diamond drilling programme (4,200m) designed to infill the resources at Kaapelinkulma (139,000t at 6.8g/t Au for 30,300oz of gold) returned encouraging assay results. These included 1.65m at 34.07 g/t gold, 2.05m at 4.32 g/t gold, 3.65m at 2.23 g/t gold, 2.20m at 3.17 g/t gold, 2.50m at 7.51 g/t gold, 3.25m at 2.74 g/t gold, 2.55m at 4.14 g/t gold, 2.70m at 2.70 g/t gold and 1.60m at 6.06 g/t gold. A resource update for the project is expected in October.

**Figure 7: Kaapelinkulma**



Source: DRA

## Kuusamo – The next production centre?

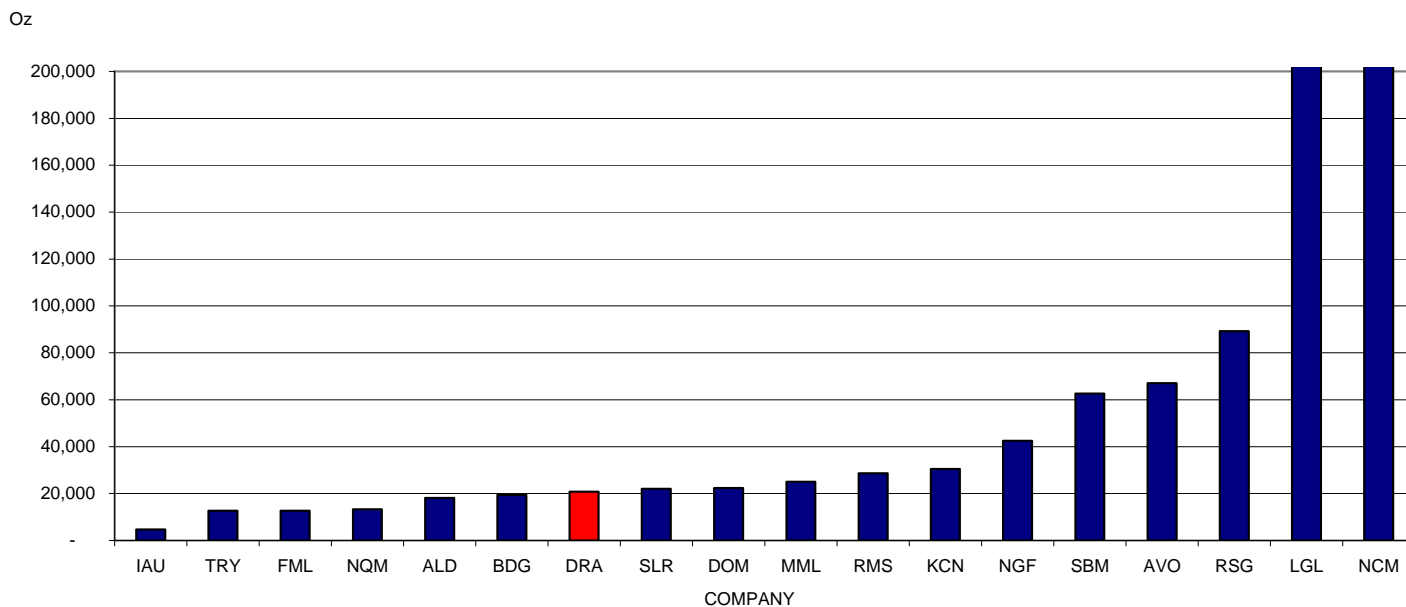
Kuusamo in north eastern Finland represents an exciting growth prospect for DRA. The company is targeting development over the next three years, to explore the depth potential of the deposit. The project contains resources of 1.35Mt at 4.1g/t Au for 178,800oz of gold. DRA is reviewing historical drilling results at Kuusamo which is expected to encourage further exploration in this region.

More than 200 holes have been drilled by Outopkompu Mining Oy (previous owner) which warrants follow up drilling. DRA has budgeted \$5m for exploration at Kuusamo over the next 12-18 months, which will include 20,000m of diamond drilling.

## Increasing production could precipitate re-rating

DRA is hopeful of boosting its production profile in the near term and we note that an increase in reserves following scheduled drilling would likely warrant a re-rating of the stock. Figure 8 below outlines the June Quarter production of DRA relative to its peers (selected ASX gold companies). DRA is leveraged to an expected strengthening in the gold price and there is further upside in the stock with a weakening of the Euro against the US dollar.

**Figure 8: June Quarter gold production (ounces)**



Source: PSL

\* LGL and NCM produced 244,000oz and 526,000oz of gold in the June Quarter, respectively.

## Directors and Management

### **Peter Cordin, Executive Chairman**

Mr Cordin is a civil engineer with more than 35 years experience in the evaluation and operation of resource projects within Australia and overseas.

### **Michael Naylor, Finance Director**

Mr Naylor is a Chartered Accountant with 14 years of mining and resource related financial experience in Australia, Canada, Europe and Africa. He has held a senior management position with a major international accounting firm in Perth and Toronto.

### **Peter Gunzburg, Non Executive Director**

Mr Gunzburg has a Commerce Degree from the University of Western Australia and over 20 years experience as a stockbroker. He is a Non Executive Director of Fleetwood and AIM-listed Brinkley Mining Plc and is the Chairman of PieNetworks.

### **Tapani Järvinen, Non Executive Director**

Mr Järvinen retired as President and CEO of Outotec Oy in December 2009. He is currently a Board member of a number of Finnish companies and Chairman of Finnish-Latin American Trade Association, the Cleantech Finland Business Forum, Laatukeskus Excellence Finland Oy and the Industry Council of Technology Academy of Finland.

### **Dr Markku Mäkelä, Non Executive Director**

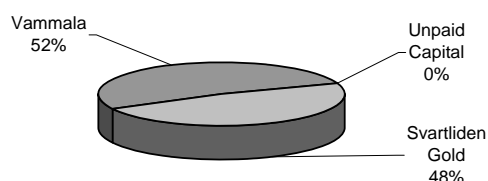
Professor Mäkelä has over 38 years experience from a variety of scientific, operational and administrative activities in the economic geological and mining sector in Finland and abroad. He remains a member of the UN Committee on Energy and Natural Resources for Development.

### **Christian Russenberger, Non Executive Director**

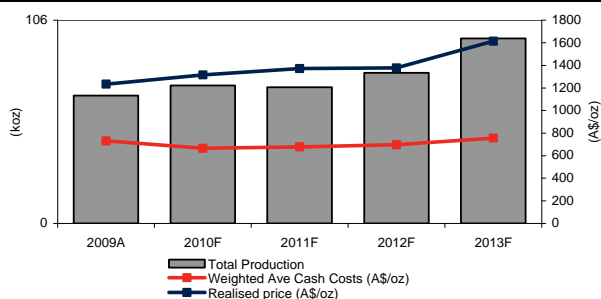
Mr Russenberger is principal and director of CR Innovations AG, BaarSwitzerland, which specialises in strategic and financial consulting to private and public micro-cap companies. He has worked as a relationship manager and analyst for Swiss banks.

Dragon Mining Limited	\$0.13	
Valuation	A\$m	A\$/sh
Svartliden Gold	65	0.09
Vammala	71	0.09
Kaapelinkulma	0	0.00
Forwards	0	0.00
Corporate	(6)	(0.01)
Exploration	15	0.02
Unpaid Capital	0	0.00
Cash	18	0.02
Debt	(8)	(0.01)
<b>Price Target (NPV)</b>	<b>157</b>	<b>0.21</b>

#### Valuation Summary of Operating Assets



#### Gold Production Summary



#### Reserves & Resources

Resources	Mt	Au g/t	Au koz
Svartliden	1.5	3.8	185
Vammala	3.2	6.1	618
Kuusamo	1.3	4.1	179
<b>Total</b>	<b>6.0</b>	<b>4.7</b>	<b>981.9</b>

Reserves	Mt	Au g/t	Au koz
Svartliden	0.5	3.5	55.3
Vammala	0.2	5.6	36
<b>Total</b>	<b>0.70</b>	<b>4.55</b>	<b>90.90</b>

#### Directors

Name	Position
Peter Cordin	Executive Chairman
Michael Naylor	Finance Director
Peter Gunzburg	Non Executive Director
Tapani Jarvinen	Non Executive Director
Markku Makela	Non Executive Director
Christian Russenburger	Non Executive Director

Substantial Shareholders	Shares (m)	%
Nicholas Mathys		17.70

Commodity Assumptions	Year End June 30				
	2009A	2010F	2011F	2012F	2013F
A\$:US\$	0.79	0.90	0.88	0.90	0.81
Gold Price (US\$/oz)	972	1176	1203	1240	1308
Gold Price (A\$/oz)	1228	1313	1371	1377	1614

Production Summary	2009A	2010F	2011F	2012F	2013F
<b>Production (koz)</b>					
Svartliden Gold	37	40	41	41	41
Vammala	29	32	30	37	55
Kaapelinkulma	0	0	0	0	0
<b>Total Production</b>	<b>67</b>	<b>72</b>	<b>71</b>	<b>78</b>	<b>96</b>

#### Cost Summary

Weighted Ave Cash Costs (A\$/oz)	730	666	678	697	755
Weighted Ave Total Costs (A\$/oz)	890	826	838	857	915
Realised price (A\$/oz)	1234	1316	1372	1377	1614

Profit & Loss (A\$m)	2009A	2010F	2011F	2012F	2013F
<b>Sales Revenue</b>	<b>75.0</b>	<b>92.1</b>	<b>85.2</b>	<b>97.0</b>	<b>125.9</b>
Other Income	0.3	0.7	1.5	3.1	4.8
Operating Costs	48.6	47.8	48.0	54.6	72.7
Exploration Exp.	0.1	1.4	1.5	0.5	0.5
Corporate/Admin	3.6	3.0	3.1	3.1	3.2

<b>EBITDA</b>	<b>23.2</b>	<b>40.6</b>	<b>34.2</b>	<b>41.9</b>	<b>54.3</b>
Depn & Amort	11.8	9.8	11.3	12.5	15.4
<b>EBIT</b>	<b>11.3</b>	<b>30.8</b>	<b>22.9</b>	<b>29.4</b>	<b>38.9</b>
Interest	2.1	0.9	0.0	0.0	0.0

<b>Operating Profit</b>	<b>9.3</b>	<b>29.9</b>	<b>22.9</b>	<b>29.4</b>	<b>38.9</b>
Tax expense	0.7	(0.8)	0.0	2.5	11.7
Abnormal Losses / Minorities	16.2	(2.1)	0.0	0.0	0.0
<b>NPAT</b>	<b>(7.6)</b>	<b>32.8</b>	<b>22.9</b>	<b>26.9</b>	<b>27.2</b>

<b>Normalised NPAT</b>	<b>3.7</b>	<b>31.3</b>	<b>22.9</b>	<b>26.9</b>	<b>27.2</b>
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Cash Flow (A\$m)	2009A	2010F	2011F	2012F	2013F
Adjusted Net Profit	(7.6)	32.8	22.9	26.9	27.2
+ Interest/Tax/Expl Exp	2.9	1.5	1.5	3.0	12.2
- Interest/Tax/Expl Inc	8.4	5.8	6.1	4.5	13.8
+ Depn/Amort	11.8	9.8	11.3	12.5	15.4
+/- Other	0.0	0.0	0.0	0.0	0.0
<b>Operating Cashflow</b>	<b>(1.4)</b>	<b>38.3</b>	<b>29.6</b>	<b>37.9</b>	<b>41.0</b>
- Capex (+asset sales)	7.5	3.5	3.5	3.6	3.7
- Working Capital Increase	(13.6)	(4.0)	0.0	0.0	0.0
- Other Investing	0.9	0.0	0.0	0.0	0.0
<b>Free Cashflow</b>	<b>4.8</b>	<b>38.8</b>	<b>26.1</b>	<b>34.3</b>	<b>37.3</b>
- Dividends (ords & pref)	0.0	0.0	0.0	0.0	0.0
+ Equity raised	0.0	0.0	0.0	0.0	0.0
+ Debt drawdown (repaid)	(7.9)	(12.2)	0.0	0.0	0.0
<b>Net Change in Cash</b>	<b>(4.1)</b>	<b>17.8</b>	<b>26.1</b>	<b>34.3</b>	<b>37.3</b>
Cash at End Period	4.4	22.2	48.3	82.5	119.9
Net Cash/(Debt)	(8.2)	22.2	48.3	82.5	119.9

Balance Sheet (A\$m)	2009A	2010F	2011F	2012F	2013F
Cash/Bullion	4.4	22.2	48.3	82.5	119.9
Total Assets	72.1	95.9	117.1	147.5	182.9
Total Debt	12.6	0.0	0.0	0.0	0.0
Total Liabilities	28.1	19.2	17.5	21.0	29.2
Shareholders Funds	43.9	76.7	99.6	126.5	153.7

Ratios	2009A	2010F	2011F	2012F	2013F
Net Debt/Equity (%)	18.7	na	na	na	na
Interest Cover (x)	5.5	32.6	na	na	na
Return on Equity (%)	na	42.7	23.0	21.3	17.7

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