Dragon Mining Limited DRA ($1.28)

Recommendation: BUY

Returning to profit in 2012

Analyst: Gary Watson

OUR VIEW

DRA reported a net loss of $0.9m for 1H CY2011, down from $20.8m NPAT for the previous corresponding period. Revenue was hampered by lower gold recoveries due to low grade stockpiles being fed through the Svartliden plant while the open pit cutback and underground decline progressed. Group cash costs were noticeably higher at US$1,228/oz, up from US$628/oz for 1H CY2010. We expect higher costs to remain for 2H CY2011, but will see cash costs reducing incrementally until 1Q CY2012 as the Svartliden cutback is completed and the underground commences ore production. A major catalyst for DRA will be the results metallurgical test work which is commencing in late 2011 at its 100% owned Kuusamo project in Finland. The uranium content of the resource is proving to be of low overall tenor but will need to be managed and the company is investigating several techniques to leach the gold and produce a cobalt concentrate. We anticipate DRA returning to profitability in CY2012. BUY with a price target of $2.32/share.

Investment Highlights

- ***Gold production improving.*** *Production from Svartliden will improve in 2H CY2011 as the reliance on treating low grade stockpiles abates. Since July areas of higher grade ore has been accessed in the east of the pit and will intermittently increase the grade of the mill feed, providing more ounces and higher recovery. However, we will continue to see low gold production until 1Q CY2012 when the cutback is complete and the underground begins producing development ore.*

- ***Costs to reduce in 2012.*** *We expect cash costs to fall back towards the US$750/oz mark heading into 2012. Cash costs were US$1,228 in 1H CY2011 due to the treatment of low grade stockpiles and cutback costs being expensed rather than capitalised. Costs will remain around US$900/oz at Svartliden for the remainder of the year while the cutback continues. Treatment of the low grade stockpiles will also continue to impact cash costs until 1Q CY2012, although at a lesser rate as time passes.*

- ***Exploration.*** *DRA has committed A$7m for exploration drilling at its Swedish and Finnish projects during 2H CY2011. Of the $7m, $3m has been committed to Kuusamo where 3 diamond drill rigs are currently working, which currently has a 383koz resource, grading 5.4g/t. Follow up drilling of the Juomasuo deposit looks likely to increase the resource, with multiple high grade intersections extending south and west of the current resource envelope.*

- ***Positive metallurgy is a key catalyst.*** *DRA is investigating several processes which could be suitable to extract the gold and produce a cobalt concentrate. Full scale metallurgical test work will commence in late 2011. We have attributed $19m to exploration value based on $50/oz for Kuusamo's 383koz resource.*

- ***Cheap versus its peers.*** *DRA appears undervalued in comparison to its peers when compared on an EV/oz basis it is trading at $72/oz compared to the industry average of $156/oz of resource. DRA is trading at 48% of our NAV.*

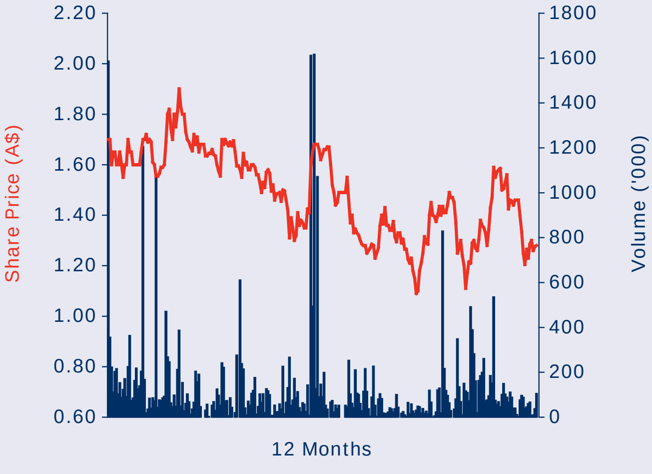
- ***Catalysts.*** *(1) Metallurgical test work at the Kuusamo project (2) Resource upgrade at Juomasuo in late October (3) First ore from Svartliden underground.*

Investment Summary

Year End December 31	2010A	2011F	2012F	2013F
Reported NPAT ($m)	30.6	6.2	28.5	44.6
Recurrent NPAT ($m)	32.3	6.5	28.5	44.6
Recurrent EPS (cents)	43.2	8.7	37.8	59.2
EPS Growth (%)	1,228.6	(79.9)	336.0	56.5
PER (x)	3.0	14.7	3.4	2.2
EBITDA ($m)	44.3	17.1	51.7	77.2
EV/EBITDA (x)	1.6	5.5	1.8	0.6
Capex ($m)	5.0	23.7	26.9	6.7
Free Cashflow	28.6	(28.4)	3.3	42.1
FCFPS (cents)	38.3	(37.7)	4.4	55.9
PFCF (x)	3.3	(3.4)	29.0	2.3
DPS (cents)	0.0	0.0	0.0	0.0
Yield (%)	0.0	0.0	0.0	0.0
Franking (%)	0.0	0.0	0.0	0.0

Company Statistics & Performance

Shares on Issue (m)	75.3	**3mth ADT ($m)**	0.127
Market Cap. ($m)	96.4	**Debt ($m)**	0.0
52 Week Range	$1.09 - $1.90	**Cash ($m)**	22.3

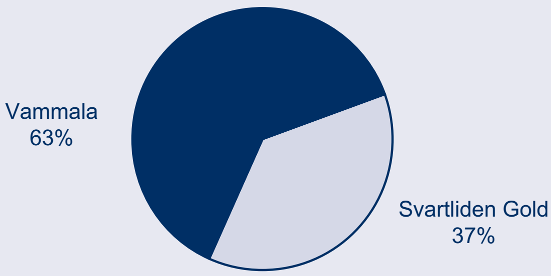


Dragon Mining Limited $1.28

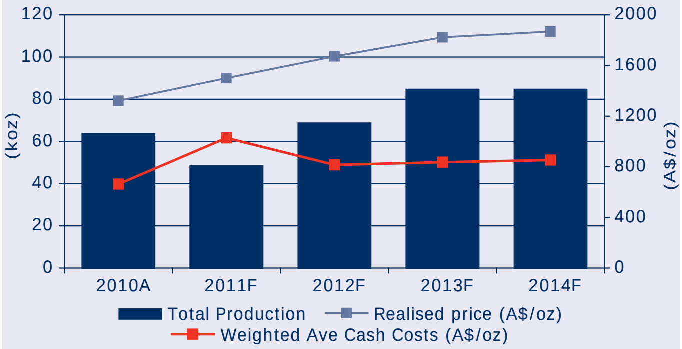
Year End December 31

Valuation	A$m	A$/sh
Svartliden Gold	53	0.71
Vammala	90	1.19
Forwards	(4)	(0.06)
Corporate	(6)	(0.07)
Exploration	19	0.25
Unpaid Capital	0	0.00
Cash	22	0.30
Equity Investment	1	0.01
Debt	0	0.00
Price Target (NAV)	**175**	**2.32**

Valuation Summary of Operating Assets



Gold Production Summary



Reserves & Resources

Resources	**Mt**	**Au g/t**	**Au koz**
Svartliden	1.3	3.8	157
Vammala	3.2	5.7	583
Kuusamo	2.2	5.4	384
Total	**6.7**	**5.0**	**1123.8**

Reserves	**Mt**	**Au g/t**	**Au koz**
Svartliden	1.0	3.2	103
Vammala	0.9	4.5	128
Total	**1.89**	**3.84**	**231.0**

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	**%**
Eurogold Limited	19
Nicholas Mathys	15

Commodity Assumptions	2010A	2011F	2012F	2013F
A$:US$	0.93	1.03	1.02	0.98
Gold Price (US$/oz)	1227	1587	1771	1787
Gold Price (A$/oz)	1321	1538	1741	1823

Production Summary	2010A	2011F	2012F	2013F
Production (koz)				
Svartliden Gold	32	24	33	31
Vammala	31	25	36	53
Total Production	**64**	**48**	**69**	**85**
Cost Summary				
Weighted Ave Cash Costs (A$/oz)	663	1028	815	837
Weighted Ave Total Costs (A$/oz)	823	1188	975	997
Realised price (A$/oz)	1321	1500	1672	1823

Profit & Loss (A$m)	2010A	2011F	2012F	2013F
Sales Revenue	**92.0**	**74.7**	**114.6**	**154.3**
Other Income	0.7	1.0	0.1	1.1
Operating Costs	42.9	51.2	55.9	70.8
Exploration Exp.	0.5	3.7	3.1	3.1
Corporate/Admin	5.0	3.7	4.1	4.2
EBITDA	**44.3**	**17.1**	**51.7**	**77.2**
Depn & Amort	8.1	7.8	11.0	13.5
EBIT	**36.2**	**9.3**	**40.7**	**63.7**
Interest	1.1	0.2	0.0	0.0
Operating Profit	**35.1**	**9.2**	**40.7**	**63.7**
Tax expense	2.8	2.6	12.2	19.1
Abnormal Losses / Minorities	1.7	0.3	0.0	0.0
NPAT	**30.6**	**6.2**	**28.5**	**44.6**
Normalised NPAT	**31.8**	**6.4**	**28.5**	**44.6**

Cash Flow (A$m)	2010A	2011F	2012F	2013F
Adjusted Net Profit	30.6	6.2	28.5	44.6
+ Interest/Tax/Expl Exp	4.1	6.5	15.3	22.2
- Interest/Tax/Expl Inc	9.5	16.9	24.5	31.6
+ Depn/Amort	8.1	7.8	11.0	13.5
+/- Other	0.0	0.0	0.0	0.0
Operating Cashflow	**33.3**	**3.7**	**30.3**	**48.7**
- Capex (+asset sales)	5.0	23.7	26.9	6.7
- Working Capital Increase	1.4	8.6	0.0	0.0
- Other Investing	0.0	0.0	0.0	0.0
Free Cashflow	**27.0**	**(28.7)**	**3.3**	**42.1**
- Dividends (ords & pref)	0.0	0.0	0.0	0.0
+ Equity raised	(5.5)	0.0	0.0	0.0
+ Debt drawdown (repaid)	(5.2)	(2.0)	(3.1)	0.0
Net Change in Cash	**24.2**	**(30.7)**	**0.2**	**42.1**
Cash at End Period	36.0	5.3	5.5	47.6
Net Cash/(Debt)	36.0	2.2	5.5	47.6

Balance Sheet (A$m)	2010A	2011F	2012F	2013F
Cash	23.5	5.3	5.5	47.6
Total Assets	87.5	108.9	144.7	199.8
Total Debt	0.0	3.1	0.0	0.0
Total Liabilities	16.4	31.6	38.9	49.5
Shareholders Funds	71.0	77.3	105.8	150.4
Ratios				
Net Debt/Equity (%)	na	na	na	na
Interest Cover (x)	32.5	56.2	1622.0	na
Return on Equity (%)	43.1	8.1	26.9	29.7