

DACIAN GOLD LIMITED

Our top pick of the ASX gold developers

Analyst Steuart McIntyre
Email steuartmcintyre@boeq.com.au
Phone +61 2 8072 2909
Date 23 February 2016

We say

Price

Target

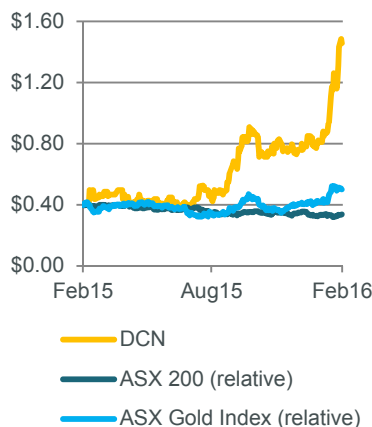
Strategic Target

BUY

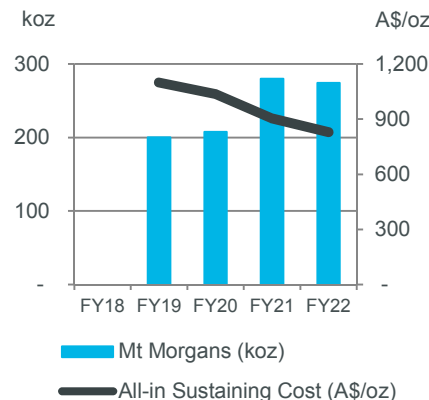
1.46 1.90 2.70

Dacian remains our top pick of the ASX gold developers and after the recent rally in gold prices, the project economics for Mt Morgan are now even more compelling. With A\$24.4m in cash at end Dec, Dacian is well funded and with 7 drill rigs on site we expect strong news flow, and expect drill results to be released every 2-3 weeks for the next 6-9 months. Given the exploration success to date, we believe it is highly likely Dacian will continue to find high-grade gold. Maintain Buy.

DCN SHARE PRICE (A\$)



FORECAST PRODUCTION & COSTS



COMPANY DATA

Enterprise value	A\$188m
Diluted market cap*	A\$213m
Diluted shares*	146m
Free float	100%
12 month price range	0.38-1.50
GICS sector	Materials
Management holds ~10% (fully diluted)	
* Diluted for 13.3m options	

IMPLIED RETURN

Total expected return	30%
-----------------------	-----

A COMPELLING PROJECT AT SPOT GOLD

At spot gold, on our forecasts DCN's Mt Morgan's project has a compelling post-tax IRR of 68%, a payback of 15 months (on an initial mine life of ~7 years) and an NPV of A\$386m (around double DCN's Mcap of ~A\$200m). So while DCN has had a good run, we see considerably more upside potential for the company's share price.

STRONG NEWSFLOW

With A\$24.4m in cash at end Dec and 7 drill rigs on site, we expect strong news flow from DCN over the next 6-9 months. We expect a new set of drill results to be released every 2-3 weeks, a resource update at Jupiter in the June Q, a resource update at Westralia in the Sept Q and a Feasibility Study for Mt Morgans in Dec Q. In parallel, exploration success at Callisto or Cameron Well *could* be a game-changer.

WHY GOLD FIELDS IS HIGHLY LIKELY TO MAKE A BID FOR DCN

Gold Fields owns the 3.5mtpa Granny Smith mill which sits only 15-25km from DCN's ground and has 1.8mtpa of underutilised capacity. Gold Fields also has stated it is "actively seeking M&A opportunities". **On our forecasts, DCN's assets are worth over A\$500m to Gold Fields and we believe an approach is more a case of when rather than if.**

IMPROVING OUTLOOK FOR GOLD

We believe the outlook and sentiment for gold and gold equities is continuing to improve. In our view, the recent rally in the US\$ gold price was primarily driven by Fed commentary about weaker global growth rates, resulting in tempered market expectations about further rate rises this year.

For at least 18 months leading up to the Fed rate rise in Dec last year, the gold price was caught up in a “negative feedback loop” – every time the Fed reiterated its intention to raise rates, the gold price seemed to take another US\$10-20/oz hit (arguably on the same news).

We believe that “feedback loop” could now be reversed, and we could be entering a period, where every time the Fed releases market commentary, it makes reference to weak global growth rates, pushing out market expectations of Fed rises and resulting in a similar ~US\$10-20/oz rally in the gold price.

STRONG NEWS FLOW NEAR TERM

Dacian is well funded and had \$24.4m in cash at end Dec 215 after raising \$25m in Nov at A69c. The company has an aggressive infill and extensional drill programme underway with 7 drill rigs on site. The company’s drill programme comprises:

- 50,000m diamond drill programme at Westralia (129 holes)
 - o Assays received for first 17 holes (11 Feb)
- 30,000m drill programme at Jupiter (310 holes)
 - o Assays received for 138 RC holes (8 Feb)

The company also has a number of greenfields targets (Callisto and Cameron Well) which it plans to drill test shortly. The company believes these targets share many characteristics with the nearby 8moz Wallaby deposit. In our view, exploration success at these targets has the potential to be a game-changer for the company.

We expect strong news flow for DCN over the next 6-9 months:

- Drill results likely to be released every 2-3 weeks for the next 6-9 months
- Jupiter resource update due June Q 2016
- Westralia resource update due Sept Q 2016
- Mt Morgans Feasibility Study due for completion in the Dec Q 2016

Our View: Given its exploration success to date, we believe it is highly likely that Dacian will continue to find high-grade gold mineralisation... supplementing the feed for Mt Morgans and further boosting the already compelling project economics.

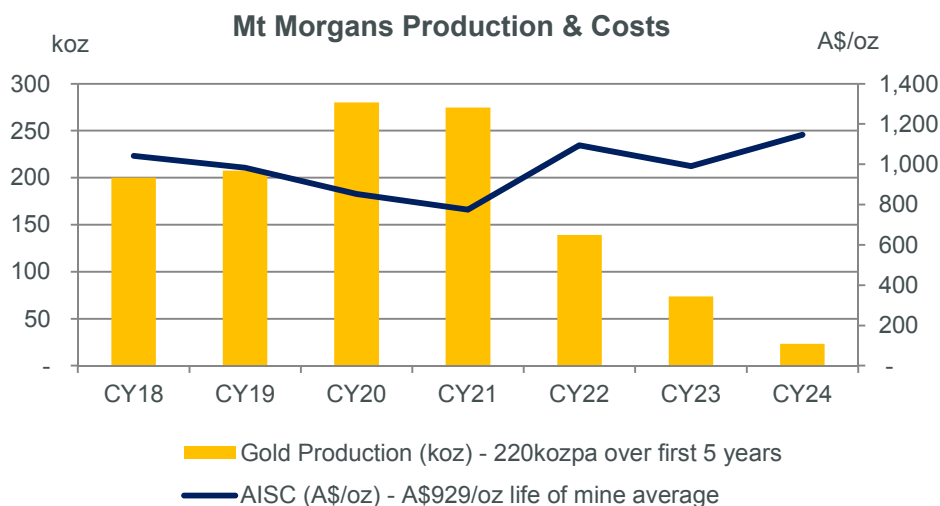
MT MORGANS SCOPING STUDY

As a brief reminder, on 30 September 2015, Dacian delivered a Scoping Study for its Mt Morgans gold project as summarised below:

Mt Morgans – Key Scoping Study Metrics	
Initial Capex	A\$157m
Plant Size	2.5mtpa
Gold Production	220kozpa over initial 5 years
All-in Sustaining Cost	A\$929/oz average life of mine
Initial mine life*	7 years

Source: Company. *Subject to infill drilling. Based on 49% M&I resources and 51% Inferred

The chart below shows the company's planned production profile and our estimate of the company's All-in Sustaining Cost profile based on the information in the Scoping Study.



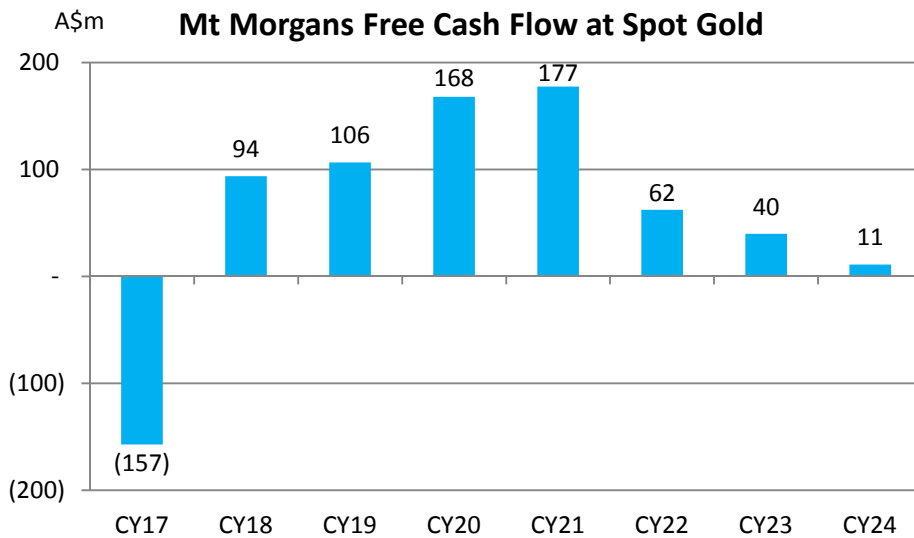
Source: Company, Blue Ocean Estimates

While infill drilling is still required, in our view the Mt Morgans Scoping Study clearly demonstrates the potential for **a very robust project**. The table below summarises key financial metrics at spot prices¹ on company assumptions:

Mt Morgans Financial Metrics – A very robust project at spot prices	
Post-Tax IRR	68%
Payback	~15 months
Average AISC Margin	45% or >A\$750/oz
Post-Tax NPV (7% nominal)	A\$386m

Source: Blue Ocean estimates

¹ Flat US\$1,209/oz gold and 0.72 A\$/US\$



Source: Blue Ocean Equities. Note: Using US\$1,209/oz gold and 0.72 A\$/US\$.

SENSITIVITIES – COMPELLING PROJECT METRICS

The three tables below use the company's Scoping Study figures to assess the key financial metrics of the Mt Morgans gold project. In our view, the outcomes below clearly demonstrate Mt Morgans is a compelling project.

Post-Tax IRR (%)	US\$ Gold Price				
	1,000	1,200	1,250	1,300	1,400
	39%	67%	74%	80%	93%

Source: Blue Ocean estimates. Assumes 0.72 A\$/US\$.

LOM AISC Margin (%)	US\$ Gold Price				
	1,000	1,200	1,250	1,300	1,400
	33%	44%	46%	48%	52%

Source: Blue Ocean estimates. Assumes 0.72 A\$/US\$.

Post-Tax NPV* (A\$m)	US\$ Gold Price				
	1,000	1,200	1,250	1,300	1,400
	193	378	424	470	562

Source: Blue Ocean estimates. *NPVs assumes 7% nominal discount rate (5% real). Assumes 0.72 A\$/US\$.

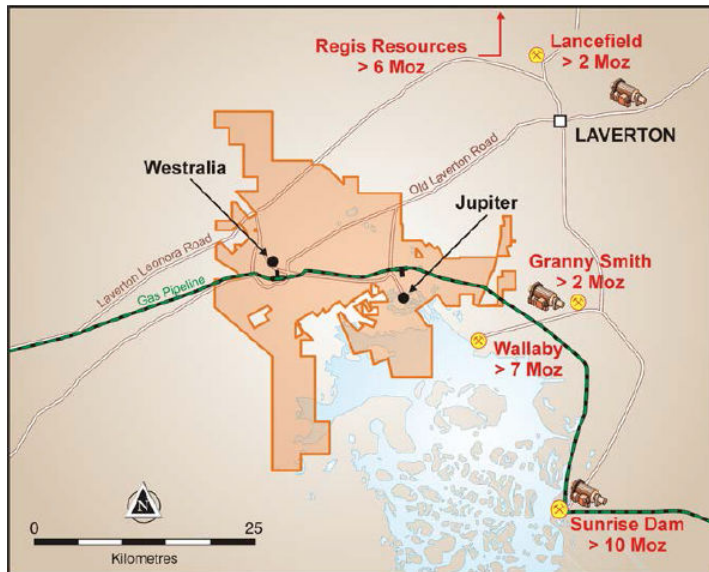
It's also important to note that the mine schedule for Mt Morgans in the Scoping Study assumed higher confidence mineralisation was mined first (i.e. M+1) rather than higher *grade* mineralisation.

Once DCN completes its infill and extensional drill programme, we believe much of the higher grade ore will be brought forward in the mine plan, further improving project economics.

WHY A BID FROM GOLD FIELDS IS HIGHLY LIKELY

In our view, there are a number of potential suitors for Dacian, but the most likely candidate is Gold Fields.

Gold Fields owns the 3.5mtpa Granny Smith CIP plant which is located nearby, <15km from Jupiter and ~25km from Westralia, and has **~1.8mtpa of unutilised capacity**².



Source: Company

Gold Fields also has one of the most aggressive gold exploration programmes in WA, spending A\$91m during CY15 and with a budget of A\$86m in CY16. Gold Fields is also **“Actively Seeking M&A Opportunities”**³

On our forecasts, at spot pricing:

- DCN’s Mt Morgans project has an NPV of A\$386m, net of initial capex of A\$157m
- But Gold Fields already has a plant (Granny Smith), so Mt Morgans is actually worth *more* to Gold fields than it is to DCN
- **Thus, Mt Morgans is probably worth over A\$500m to Gold Fields (vs. DCN’s market cap of ~A\$200m)**

Bottom line: We believe a Gold Fields approach to DCN is more a question of *when* rather than if, and is probably contingent on infill drilling at Westralia providing more confidence on continuity of mineralisation.

Dacian has \$24.4m in cash and 7 rigs on site and its intensive infill and extensional drilling programme is underway.

² Gold Fields Q2 2015 conference call transcript, p6
https://www.goldfields.com/pdf/presentations/2015/conference_call_transcript_20150821.pdf

³ Gold Fields Diggers & Dealers presentation, August 2015, p29
https://www.goldfields.co.za/pdf/presentations/2015/sustaining_fcf_and_growing_the_exploration_pipeline.pdf

PRICE TARGET & RATING

We endorse Dacian's Scoping Study forecasts for Mt Morgans, but add a modest buffer to first gold production and a material 25% higher sustaining capex until higher confidence studies are completed.

Our forecasts also include **a 50% discount to the NPV for Mt Morgans** given the early stage of the project. We will review this discount as DCN achieves its key de-risking milestones.

We increase our gold prices to US\$1,250/oz (from US\$1,100/oz) leading to a 27% increase in our price target to \$1.90 (from \$1.50), an implied return of 30%. **Maintain Buy.**

STRATEGIC TARGET

To derive our \$2.70 Strategic Target we simply remove the 50% discount included in our base-case valuation. In essence, this assumes:

- the infill drilling comes in at least in line with expectations
- project economics are maintained through to DFS
- project funding is achieved in line with our estimates (50/50 debt/equity, equity issued at a 10% discount to last close).

Interestingly, if Mt Morgans is worth over A\$500m to Gold Fields (as discussed on the previous page), this would imply a value of over \$3.40, based on the *current* fully-diluted shares on issue of 146m.

KEY RISKS

Dacian is exposed to all the normal risks associated with developing and operating mining projects, including permitting, funding and construction risk.

Given the early stage nature of the Mt Morgans project, other key risks for Dacian include metallurgical recoveries (albeit somewhat offset by the fact Mt Morgans is a brownfields operation), as well as a successful infill drilling program to confirm ore bodies are sufficiently continuous to support a viable mining operation.

Many investors may also expect ongoing exploration success (and in our view that is likely) and thus Dacian also carries exploration risk.

Assuming the company makes the transition into production, the company's revenues will be derived from the sale of gold. Fluctuations in the gold price as well as the Australian dollar could impact the company's cash flow, profitability and share price.

Dacian's shares also carry an embedded Australian sovereign risk as the company's development projects are based in Western Australia.

MODEL SUMMARY – FINANCIALS & VALUATION

Stock Details

Recommendation:	BUY		
Target	\$1.90	Share Price	\$1.46
NAV	\$1.90	52 Week High	\$1.50
Implied Return	30%	52 Week Low	\$0.38

Enterprise Value	\$188m
Diluted MCap	\$213m
Diluted Shares	146m
Free Float	100%
Avg Daily Value	\$0.15m

Macro Assumptions	FY15	FY16E	FY17E	FY18E	FY19E
Exchange Rate (A\$/US\$)	0.84	0.71	0.69	0.68	0.68
Gold Price (US\$/oz)	1,224	1,162	1,250	1,250	1,250
Gold Price Realised (A\$/oz)	1,464	1,637	1,812	1,830	1,843

Profit & Loss (A\$m)	FY15	FY16E	FY17E	FY18E	FY19E
Revenue	-	-	-	-	369
Operating Costs	-	-	-	-	(195)
Operating Profit	-	-	-	-	173
Corporate & Other	(1)	(2)	(2)	(2)	(4)
Exploration Expense	(7)	(8)	(5)	(4)	(2)
EBITDA	(8)	(9)	(7)	(6)	168
D&A	(0)	(0)	(0)	(0)	(35)
EBIT	(9)	(9)	(7)	(6)	133
Net Interest Expense	0	0	0	0	(5)
Pre-Tax Profit	(8)	(9)	(7)	(6)	127
Tax Expense	0	-	-	-	(38)
Underlying Profit	(8)	(9)	(7)	(6)	89
Significant Items (post tax)	-	-	-	-	-
Reported Profit	(8)	(9)	(7)	(6)	89

Cash Flow (A\$m)	FY15	FY16E	FY17E	FY18E	FY19E
Operating Cashflow	(1)	(2)	(2)	(2)	169
Tax	-	-	-	-	-
Net Interest	0	0	0	0	(5)
Net Operating Cash Flow	(1)	(1)	(2)	(2)	164
Exploration	(6)	(9)	(6)	(4)	(2)
Capex	(0)	(4)	(1)	(160)	(19)
Acquisitions / Disposals	-	-	-	-	-
Other	(0)	0	0	0	0
Net Investing Cash Flow	(6)	(12)	(7)	(164)	(21)
Equity Issue	-	25	85	5	1
Borrowing / Repayments	(0)	-	-	85	(85)
Dividends	-	-	-	-	-
Other	(0)	-	-	-	-
Net Financing Cash Flow	(0)	25	85	90	(84)
Change in Cash Position	(6)	11	77	(76)	59
FX Adjustments	-	-	-	-	-
Cash Balance	5	16	93	17	76

Balance Sheet (A\$m)	FY15	FY16E	FY17E	FY18E	FY19E
Cash	5	16	93	17	76
Other Current Assets	0	0	0	0	0
PP&E	0	4	5	165	148
Exploration & Development	8	9	10	10	10
Other Non Current Assets	0	0	0	0	0
Total Assets	14	29	108	192	235
Debt	0	0	0	85	0
Other Liabilities	3	3	3	3	41
Net Assets	10	26	104	104	193

Ratio Analysis		FY15	FY16E	FY17E	FY18E	FY19E
Diluted Shares	m	96	146	210	216	217
EPS - Diluted	Ac	(8.4)	(6.7)	(4.3)	(2.7)	41.1
P/E	x	n.m.	n.m.	n.m.	n.m.	3.6x
CFPS - Diluted	Ac	(0.7)	(1.0)	(1.0)	(1.0)	75.6
P/CF	x	n.m.	n.m.	n.m.	n.m.	1.9x
FCF - Diluted	Ac	(1.0)	(3.7)	(1.5)	(75.0)	69.3
P/FCF	x	n.m.	n.m.	n.m.	n.m.	2.1x
Dividends	Ac	-	-	-	-	-
Dividend yield	%	-	-	-	-	-
Payout Ratio	%	-	-	-	-	-
Franking	%	-	-	-	-	-
Enterprise Value	A\$m	208	197	120	281	137
EV/EBITDA	x	(24.8x)	(21.2x)	(17.5x)	(46.8x)	0.8x
ROE	%	(78%)	(35%)	(7%)	(6%)	46%
ROA	%	(59%)	(31%)	(6%)	(3%)	38%
Net Debt / (Cash)		(5)	(16)	(93)	68	(76)
Gearing (ND/(ND+E))	%	n.m.	n.m.	n.m.	40%	(64%)
Gearing (ND/E)	%	n.m.	n.m.	n.m.	66%	(39%)

	P&P Reserves			M&I Resources			Inferred
	mt	g/t	moz	mt	g/t	moz	moz
Westralia	-	-	-	2.2	4.7	0.33	1.19
Jupiter	-	-	-	13.1	1.4	0.60	0.48
Transvaal	-	-	-	0.8	5.5	0.14	0.07
Other	-	-	-	3.7	0.8	0.10	0.14
Sub Total	-	-	-	19.7	1.8	1.17	1.88
Total							3.0

Earnings Sensitivity			FY19E	FY20E	FY19E	FY20E
			A\$m	A\$m	%	%
Gold Price	US\$/oz	+10%	25	27	28%	25%
Exchange Rate	A\$/US\$	-10%	28	30	31%	28%

Valuation	Discount	Stake	A\$m	A\$/sh
Mt Morgans (un-risked)		100%	494	3.39
Mt Morgans (risk adjusted)	50%	100%	247	1.70
Exploration			20	0.14
Corporate & Other			(25)	(0.17)
Debt			-	-
Cash			24.4	0.17
Option Strikes			11.1	0.08
Risk adjusted NAV			277	1.90

Source: IRESS, Company data, Blue Ocean estimates

MODEL SUMMARY – INPUTS & FREE CASH FLOW

Operational Summary							Macro Assumptions						
		FY18E	FY19E	FY20E	FY21E	FY22E			FY18E	FY19E	FY20E	FY21E	FY22E
Mt Morgans - Mining							FCF Contribution						
<u>Open Pit Ore</u>							A\$m						
Percent from Open Pits	%	-	66%	74%	65%	45%	Exchange Rate	A\$/US\$	0.68	0.68	0.67	0.67	0.67
Open Pit Mill Feed	kt	-	2,115	2,460	2,321	1,033	Gold Price	US\$/oz	1,250	1,250	1,250	1,250	1,250
Open Pit Head Grade	g/t	-	1.3	1.4	1.5	1.0	Gold Price Realised	A\$/oz	1,830	1,843	1,857	1,865	1,866
<u>Underground Ore</u>							Mt Morgans						
Percent from Underground	%	-	34%	26%	35%	55%	Revenue		-	369	385	522	512
Underground Mill Feed	kt	-	1,079	867	1,229	1,260	Operating Costs		-	195	193	220	187
Underground Head Grade	g/t	-	4.4	4.6	5.9	6.0	Sustaining Capex		-	19	16	28	35
Mt Morgans - Processing							Sustaining Exploration						
Mill Throughput	mt	-	2.3	2.5	2.5	2.5	Corp Overheads		2	4	4	4	4
Head Grade	g/t	-	3.0	2.8	3.8	3.8	All-in Sustaining Margin		(2)	149	170	269	285
Recovery	%	-	91%	92%	91%	91%							
Gold Production	koz	-	200	208	280	275							
All-in Sustaining Cost	A\$/oz	-	1,100	1,037	904	829							
							Operations						
							A\$m						
Group													
		FY18E	FY19E	FY20E	FY21E	FY22E	Revenue		-	369	385	522	512
Gold Production	koz	-	200	208	280	275	All-in Sustaining Cost		2	220	215	253	228
All-in Sustaining Cost	A\$/oz	-	1,100	1,037	904	829	All-in Sustaining Margin		(2)	149	170	269	285
							Growth Capex						
							Growth Exploration						
							All-in Margin						
							(166)						
							149						
							170						
							269						
							285						
							Corporate						
							A\$m						
							Cash Tax						
							Other Items						
							FCF pre Debt Service						
							Net Interest						
							Debt Drawdown / (Repayment)						
							FCF post Debt Service						
							(81)						
							58						
							150						
							214						
							213						
							New Equity/Dividends						
							A\$m						
							Proceeds from Shares/Options						
							Dividends Paid						
							Change in Cash						
							(76)						
							59						
							139						
							185						
							169						
							Cash Balance						
							17						
							76						
							215						
							399						
							568						

Source: IRESS, Company data, Blue Ocean estimates

CONTACTS

ANALYST

Steuart McIntyre

Senior Resource Analyst

P +61 2 8072 2909

E steuartmcintyre@boeq.com.au

AUTHORITY

David O'Halloran

Executive Director

P +61 2 8072 2904

E doh@boeq.com.au

CONTACTS

Rex Adams

Executive Director

P +61 2 8072 2905

E rex@boeq.com.au**Gregg Taylor**

Senior Industrials Analyst

P +61 2 8072 2919

E greggtaylor@boeq.com.au**Philip Pepe**

Senior Industrials Analyst

P +61 2 8072 2921

E philpepe@boeq.com.au**Stuart Turner**

Senior Analyst

P +61 2 8072 2923

E stuartturner@boeq.com.au**Neon Shariful**

Investment Analyst

P +61 2 8072 2910

E neonshariful@boeq.com.au**Emily Mohan**

Investment Analyst

P +61 2 8072 2907

E emily@boeq.com.au**Adam Stratton**

Institutional Dealing

P +61 2 8072 2913

E adamstratton@boeq.com.au**Doc Cromme**

Institutional Dealing

P +61 2 8072 2910

E doccromme@boeq.com.au**Nic van Vliet**

Institutional Dealing

P +61 2 8072 2929

E nvv@boeq.com.au**Scott Calcraft**

Institutional Dealing

P +61 2 8072 2920

E scottcalcraft@boeq.com.au**Tim Potts**

Institutional/HNW Dealing

P +61 2 8072 2906

E timpotts@boeq.com.au**Josie Nicol**

Dealing Associate

P +61 2 8072 2931

E josienicol@boeq.com.au

HEAD OFFICE

Blue Ocean Equities Pty. Ltd.

P +61 2 8072 2988

E info@boeq.com.auwww.blueoceanequities.com.au

L 29 Aurora Place

88 Phillip St

Sydney NSW 2000

Australia

AFSL No. 412765

ABN 53 151186935

DISCLAIMER

This document is a private communication to clients and is not intended for public circulation or for the use of any third party, without the prior approval of Blue Ocean Equities Pty Limited. This is general investment advice only and does not constitute personal advice to any person. Because this document has been prepared without consideration of any specific client's financial situation, particular needs and investment objectives you should consult your own investment adviser before any investment decision is made on the basis of this document.

While this document is based on information from sources which are considered reliable, Blue Ocean Equities Pty Limited has not verified independently the information contained in the document and Blue Ocean Equities Limited and its directors, employees and consultants do not represent, warrant or guarantee, expressly or by implication, that the information contained in this document is complete or accurate. Nor does Blue Ocean Equities Limited accept any responsibility for updating any advice, views opinions, or recommendations contained in this document or for correcting any error or omission which may become apparent after the document has been issued.

Except insofar as liability under any statute cannot be excluded. Blue Ocean Equities Pty Limited and its directors, employees and consultants do not accept any liability (whether arising in contract, in tort or negligence or otherwise) for any error or omission in this document or for any resulting loss or damage (whether direct, indirect, consequential or otherwise) suffered by the recipient of this document or any other person.

DISCLOSURE

Blue Ocean Equities Pty Limited, its employees, consultants and its associates within the meaning of Chapter 7 of the Corporations Law may receive commissions, underwriting and management fees from transactions involving securities referred to in this document, and may from time to time hold interests in the securities referred to in this document.

Blue Ocean Equities Pty Limited and associates hold no shares in Dacian at the date of this report and this position may change at any time without notice.