

# DACIAN GOLD LIMITED (DCN)

## INCREASING PRICE TARGET TO \$4.20

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**Date** 27 June 2016

**We say**

# BUY

**Price**

# 2.69

**Target**

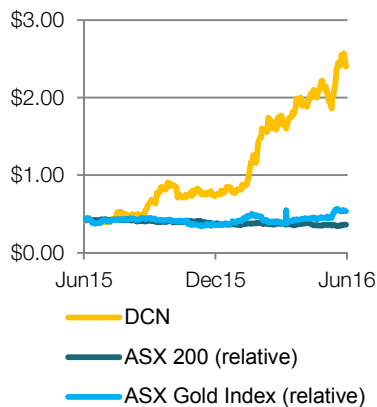
# 4.20

**Strategic Target**

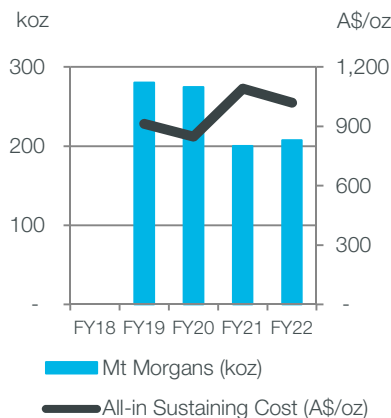
# 6.50

Dacian remains our top pick of the ASX gold developers and due to the continued success of the infill drilling programme and the continued re-rating of gold equities. We maintain our Buy rating and upgrade our price target to \$4.20 (from \$3.30) on 12% higher gold prices of US\$1,400/oz (from US\$1,250/oz). We see potential for Cameron Well to add at least 300-400koz near term (and potentially as much as 1moz longer term) which could increase the mine life at Mt Morgans to 8-10 years.

### DCN SHARE PRICE



### FORECAST PRODUCTION & COSTS



### COMPANY DATA & RATIOS

Enterprise value	\$375m
Diluted market cap*	\$392m
Diluted shares*	146m
Free float	100%
12 month price range	0.38-2.78
GICS sector	Materials
Management holds ~10% (fully diluted)	
*Diluted for 13.3m options	

### IMPLIED RETURN

Implied all-in return	56%
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## WE EXPECT MINE LIFE TO STRONG NEWSFLOW GROW TO 8-10 YEARS NEAR-TERM

In our view there are several areas where Dacian could find more ounces near-term. We believe the most prospective targets include Cameron Well, Jupiter extensions and Callisto. We also believe increasing the mine life towards 10 years would add *significant* appeal for institutional investors.

With A\$17m in cash at end March and 7 drill rigs on site, we expect strong news flow from DCN over the next 3-6 months:

- Westralia underground results due shortly (a *key* catalyst in our view)
- Callisto drilling to begin in July with initial results by month end (success could be a game-changer for DCN)
- 3 resource upgrades in July (Jupiter, Westralia & Morgans)

## INCREASE PRICE TARGET TO \$4.20

We increase our price target for Dacian to \$4.20 based on 12% higher gold prices of US\$1,400/oz (from US\$1,250/oz) and a 20% discount to NPV.

With its strong management team, compelling project metrics at Mt Morgan and raft of near-term news flow, Dacian remains our Top Pick in the ASX gold space for 2016.

## AN IMPROVING MACRO FOR GOLD ON BREXIT

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On Friday last week, the UK surprised global markets with 52/48% vote in favour of the UK leaving the EU. In our view, this is a key tipping point for gold which we now believe is firmly in a bull market and we upgrade our gold prices 12% to US\$1,400/oz from US\$1,250/oz.

We see a number of key drivers for the gold price near-term:

- **Increased Global Uncertainty:** In our view, the UK's decision to leave the EU last week represents a clear increase in global uncertainty, which we believe could potentially persist for some weeks and perhaps longer. Uncertainty is usually positive for gold.
- **Increased Geopolitical Risk and Fear of Contagion in the EU:** Polls recently conducted in Italy, France, Germany, Sweden, the Netherlands, Czech Republic and Hungary have showed that these countries could follow Britain if it succeeds in leaving the EU. As such, near-term we believe Brexit has heightened the market's fear of other countries leaving the EU. Given the elevated sovereign debt levels of some member states (like Italy & Greece), we believe this could lead to fears of further financial shocks. Increased fear (of any kind) is usually positive for gold.
- **Risk of Weaker Global Growth:** Given the increase in global uncertainty, we believe some industries are likely to delay investment and hiring decisions, particularly in Europe. The Brexit news could not come at worse time Europe, where recent growth in some areas has been anemic at best.
- **Tempered Rate Hikes from the Fed:** We believe Brexit is likely to lead to further tempering of the Fed's current rate hiking cycle. While we still believe the Fed may raise rates one more time this year, many market participants believe the rate hiking cycle could now be over and some are suggesting the next move from the Fed could even be a rate cut or further stimulus. Any tapering of the Fed's rate hike is likely to be positive for gold.
- **Further Central Bank Stimulus:** If the Fed confirms our view that the outlook for global and domestic growth is now weaker, it has relatively limited options to stimulate growth. It will almost certainly need to slow the rate hiking cycle, but may also need to consider further stimulus or quantitative easing. In layman's terms, this means increasing the money supply. We believe further stimulus from the Fed would be a positive for gold.
- **Low Real Interest Rates Likely to Persist:** However you cut it, we believe Brexit increases the chance that low real interest rates are more likely to persist – a clear positive for gold prices and gold equities.
- **Big Upgrades Coming:** Importantly, most of the sell side has missed the last 20-30% of the recent rally in gold equities. We were one of the last sell side brokers to take our Buy off Newcrest (at ~\$18) but arguably we *still* got it wrong (and by a material margin). We believe Brexit could be the catalyst which *forces* the sell side to reassess and upgrade both gold prices and begin to reintroduce a premium to NAV for gold equities. As such, we expect to see a raft of material upgrades from the sell side on gold equities and recommend buying ahead of this.

## UPGRADING OUR PRICE TARGET TO \$4.20

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We maintain our high conviction Buy on Dacian and upgrade our Price Target to \$4.20 (from \$3.30) based on:

- US\$1,400/oz gold (from US\$1,250/oz) and the A\$/US\$ forward curve (0.74 declining to 0.67 over 5 years)
- An unchanged 20% discount to NPV, or 0.8x NPV. Many of DCN's producing peers are trading at 1.4-1.5x NAV.

We also believe Dacian is highly likely to increase the mine life at Mt Morgans to 8-10 years (from the current ~7 years), which we believe would add *significant* appeal for institutional investors.

## STRATEGIC TARGET

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To calculate our Strategic Target we assume:

- US\$1,400/oz gold and A\$/US\$ on the forward curve (as described above)
- Our NPV for Dacian in production is \$4.65
- Our \$6.50 Strategic Target assumes Dacian trades at 1.4x NPV once in production

## DON'T FORGET ABOUT GOLD FIELDS...

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Dacian's Mt Morgan's project sits only ~20km from Gold Fields Granny Smith 3.5mtpa processing plant... which is currently only at ~50% capacity. [We continue to believe there is a strong chance that Gold Fields bids for Dacian at some point](#)... for us, the primary question is *when*.

Since Dacian has to spend A\$157m building a new processing plant, Dacian's Mt Morgan's project is actually [worth ~A\\$157m more to Gold Fields than it is to DCN](#) (or anyone else for that matter)...

Our best guesses as to when a bid might come include:

- (1) Shortly after Dacian releases its infill drilling results for the Westralia underground, due shortly (de-risking the continuity of this important underground resource)
- (2) If the company has material exploration success at Callisto. Drilling due to commence in July with initial results by month end.
- (3) Post the release of the final feasibility study in Q4 CY16, before Dacian begins construction (probably the most likely in our view)

## CALLISTO: POTENTIAL TO BE A GAME-CHANGER

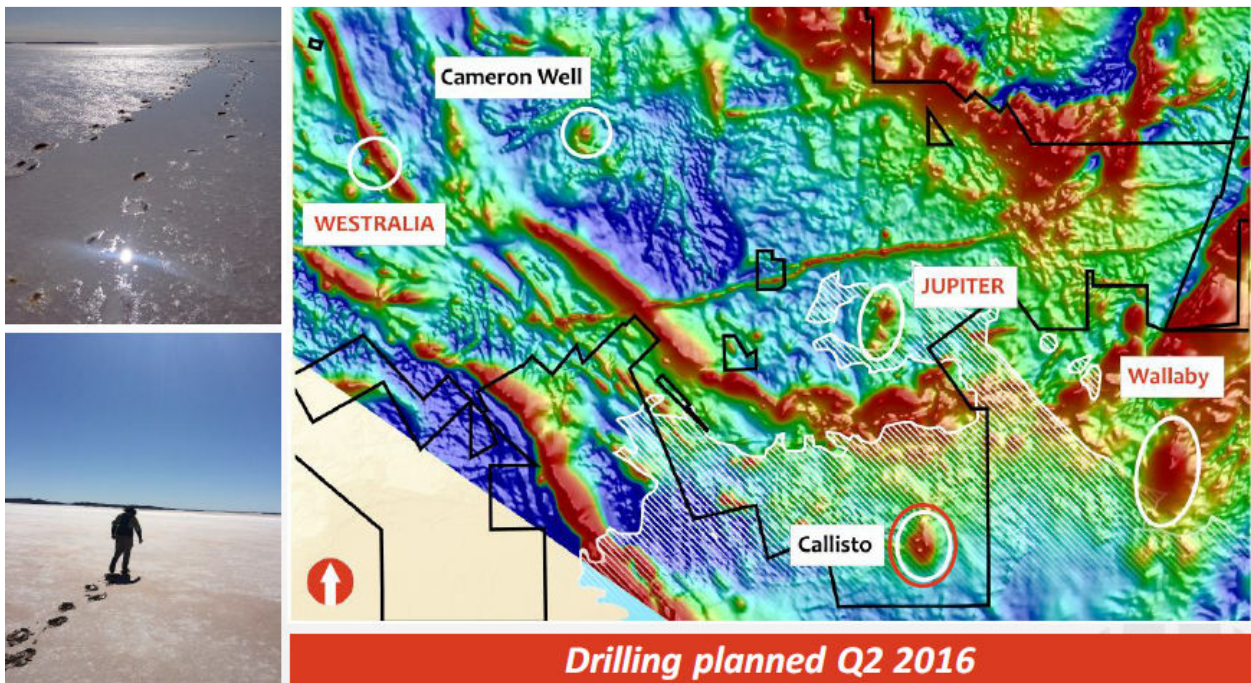
Callisto is a magnetic anomaly which sits 6-7km from the 8moz Wallaby gold deposit.

The anomaly sits 4km into a salt lake (shown in white below) making access very difficult. Which is probably why there have only been 3 holes drilled into this anomaly in the past ~30 years and the reason for the magnetic signature has never been identified.

The company believes the target magnetic rocks lie ~250m below the surface and could be associated with a syenite just like Wallaby.

The company is planning to drill test this underground target with 2 x 800m diamond scissor holes sometime [in early July with initial results likely by the end of the month.](#)

**Could Callisto be a mineralised syenite like Jupiter and Wallaby?**

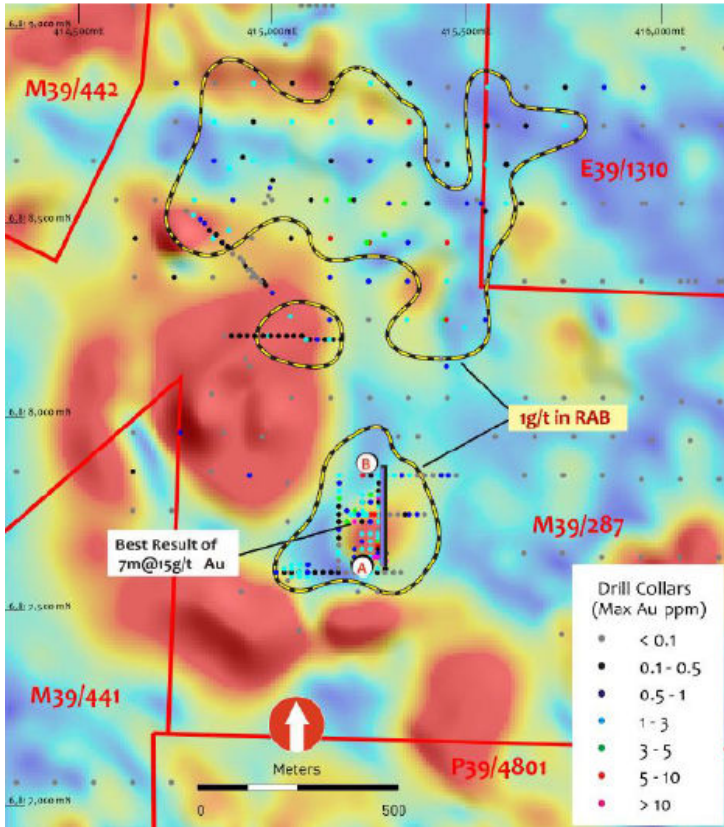


Source: Company

**Our View:** Given the Wallaby deposit is one of the best discoveries in this region in terms of both size and grade, exploration success at Callisto could be a game-changer for DCN.

## CAMERON WELL: 300-400Koz AND UP TO 1MOZ?

Cameron Well is a donut-shaped magnetic anomaly which lies 8-9km from Jupiter. This prospect had some very promising historic drilling results from over 20 years ago (1992/1994).



Source: Company

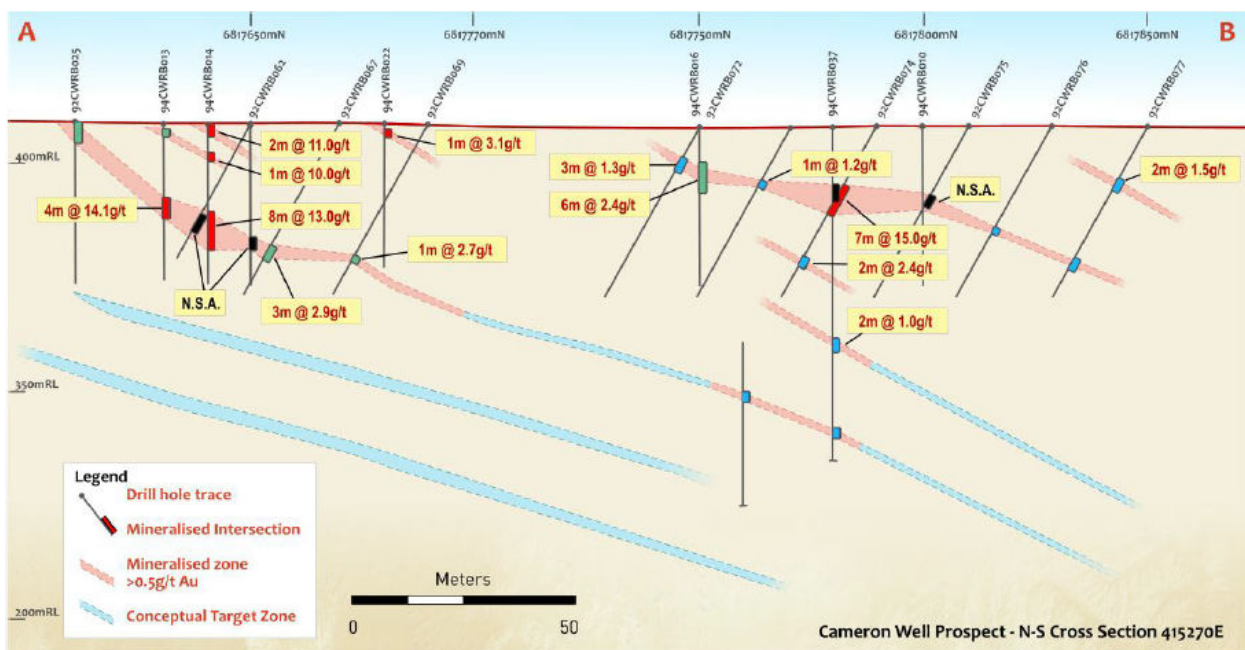
The top outlined area is 800m by 500m and has a number of promising gold hits.

Similarly, the smaller outline with the A-B section has had a number of promising RAB/aircore holes to depths of only 40m confirming:

- High-grade, near-surface gold mineralisation
- including 7m @ 15g/t, 8m @ 13g/t, etc
- Similar flat-lying gold structures Jupiter

**We believe this prospect could host at least 300-400koz and potential as much as 1moz in time.**

### Cameron Well: Section A-B from the picture above



Source: Company

## KEY RISKS

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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:	<b>BUY</b>		
Target	\$4.20	Share Price	\$2.69
NAV	\$4.18	52 Week High	\$2.78
Implied Return	56%	52 Week Low	\$0.38

Enterprise Value	\$375m
Diluted MCap	\$392m
Diluted Shares	146m
Free Float	100%
Avg Daily Value	\$0.42m

Macro Assumptions	FY15	FY16E	FY17E	FY18E	FY19E
Exchange Rate (A\$/US\$)	0.84	0.73	0.70	0.68	0.68
Gold Price (US\$/oz)	1,224	1,165	1,400	1,400	1,400
Gold Price Realised (A\$/oz)	1,464	1,597	2,004	2,050	2,064

Profit & Loss (A\$m)	FY15	FY16E	FY17E	FY18E	FY19E
Revenue	-	-	-	-	578
Operating Costs	-	-	-	-	(224)
<b>Operating Profit</b>	-	-	-	-	<b>354</b>
Corporate & Other	(1)	(2)	(2)	(2)	(4)
Exploration Expense	(7)	(9)	(5)	(4)	(2)
<b>EBITDA</b>	<b>(8)</b>	<b>(11)</b>	<b>(7)</b>	<b>(6)</b>	<b>348</b>
D&A	(0)	(0)	(0)	(0)	(49)
<b>EBIT</b>	<b>(9)</b>	<b>(11)</b>	<b>(7)</b>	<b>(6)</b>	<b>299</b>
Net Interest Expense	0	0	0	0	(5)
<b>Pre-Tax Profit</b>	<b>(8)</b>	<b>(10)</b>	<b>(7)</b>	<b>(6)</b>	<b>295</b>
Tax Expense	0	0	-	-	(88)
<b>Underlying Profit</b>	<b>(8)</b>	<b>(10)</b>	<b>(7)</b>	<b>(6)</b>	<b>206</b>
Significant Items (post tax)	-	-	-	-	-
<b>Reported Profit</b>	<b>(8)</b>	<b>(10)</b>	<b>(7)</b>	<b>(6)</b>	<b>206</b>

Cash Flow (A\$m)	FY15	FY16E	FY17E	FY18E	FY19E
Operating Cashflow	(1)	(1)	(2)	(2)	350
Tax	-	-	-	-	-
Net Interest	0	0	0	0	(5)
<b>Net Operating Cash Flow</b>	<b>(1)</b>	<b>(1)</b>	<b>(2)</b>	<b>(2)</b>	<b>345</b>
Exploration	(6)	(8)	(6)	(4)	(2)
Capex	(0)	(3)	(1)	(160)	(28)
Acquisitions / Disposals	-	-	-	-	-
Other	(0)	-	-	-	-
<b>Net Investing Cash Flow</b>	<b>(6)</b>	<b>(11)</b>	<b>(7)</b>	<b>(164)</b>	<b>(30)</b>
Equity Issue	-	24	85	5	1
Borrowing / Repayments	(0)	(0)	-	85	(85)
Dividends	-	-	-	-	-
Other	(0)	-	-	-	-
<b>Net Financing Cash Flow</b>	<b>(0)</b>	<b>24</b>	<b>85</b>	<b>90</b>	<b>(84)</b>
Change in Cash Position	(6)	12	77	(76)	231
FX Adjustments	-	-	-	-	-
<b>Cash Balance</b>	<b>5</b>	<b>16</b>	<b>93</b>	<b>17</b>	<b>249</b>

Balance Sheet (A\$m)	FY15	FY16E	FY17E	FY18E	FY19E
Cash	5	16	93	17	249
Other Current Assets	0	0	0	0	0
PP&E	0	3	4	164	142
Exploration & Development	8	9	9	10	10
Other Non Current Assets	0	0	0	0	0
<b>Total Assets</b>	<b>14</b>	<b>29</b>	<b>107</b>	<b>191</b>	<b>401</b>
Debt	0	0	0	85	0
Other Liabilities	3	5	5	5	93
<b>Net Assets</b>	<b>10</b>	<b>24</b>	<b>102</b>	<b>101</b>	<b>308</b>

Ratio Analysis		FY15	FY16E	FY17E	FY18E	FY19E
Diluted Shares	m	96	146	181	187	188
EPS - Diluted	Ac	(8.4)	(7.5)	(4.4)	(3.2)	110.2
<b>P/E</b>	<b>x</b>	<b>n.m.</b>	<b>n.m.</b>	<b>n.m.</b>	<b>n.m.</b>	<b>2.4x</b>
CFPS - Diluted	Ac	(0.7)	(0.5)	(1.1)	(1.1)	184.6
<b>P/CF</b>	<b>x</b>	<b>n.m.</b>	<b>n.m.</b>	<b>n.m.</b>	<b>n.m.</b>	<b>1.5x</b>
FCF - Diluted	Ac	(1.0)	(2.6)	(1.7)	(86.9)	171.6
<b>P/FCF</b>	<b>x</b>	<b>n.m.</b>	<b>n.m.</b>	<b>n.m.</b>	<b>n.m.</b>	<b>1.6x</b>

Dividends	Ac	-	-	-	-	-
Dividend yield	%	-	-	-	-	-
Payout Ratio	%	-	-	-	-	-
Franking	%	-	-	-	-	-
Enterprise Value	A\$m	387	375	299	460	143
<b>EV/EBITDA</b>	<b>x</b>	<b>(46.2x)</b>	<b>(35.7x)</b>	<b>(43.6x)</b>	<b>(76.6x)</b>	<b>0.4x</b>
ROE	%	(78%)	(43%)	(7%)	(6%)	67%
ROA	%	(59%)	(36%)	(6%)	(3%)	51%

Net Debt / (Cash)		(5)	(16)	(93)	68	(249)
Gearing (ND/(ND+E))	%	n.m.	n.m.	n.m.	40%	(417%)
Gearing (ND/E)	%	n.m.	n.m.	n.m.	67%	(81%)

	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
<b>Sub Total</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>19.7</b>	<b>1.8</b>	<b>1.17</b>	<b>1.88</b>
<b>Total</b>							<b>3.0</b>

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%	702	4.82
Mt Morgans (risk-adjusted)	20%	100%	561	3.85
Exploration			45	0.31
Corporate & Other			(25)	(0.17)
Debt			-	-
Cash			17.0	0.12
Option Strikes			11.1	0.08
<b>Risk adjusted NAV</b>			<b>609</b>	<b>4.18</b>

Source: IRESS, Company data, Blue Ocean estimates

## MODEL SUMMARY – INPUTS & FREE CASH FLOW

Operational Summary		FY18E	FY19E	FY20E	FY21E	FY22E
<b>Mt Morgans - Mining</b>						
<u>Open Pit Ore</u>						
Percent from Open Pits	%	-	65%	45%	66%	74%
Open Pit Mill Feed	kt	-	2,321	1,033	2,115	2,460
Open Pit Head Grade	g/t	-	1.5	1.0	1.3	1.4
<u>Underground Ore</u>						
Percent from Underground	%	-	35%	55%	34%	26%
Underground Mill Feed	kt	-	1,229	1,260	1,079	867
Underground Head Grade	g/t	-	5.9	6.0	4.4	4.6
<b>Mt Morgans - Processing</b>						
Mill Throughput	mt	-	2.5	2.5	2.3	2.5
Head Grade	g/t	-	3.8	3.8	3.0	2.8
Recovery	%	-	91%	91%	91%	92%
Gold Production	koz	-	280	275	200	208
All-in Sustaining Cost	A\$/oz	-	920	856	1,098	1,024

Macro Assumptions		FY18E	FY19E	FY20E	FY21E	FY22E
Exchange Rate	A\$/US\$	0.68	0.68	0.67	0.67	0.67
Gold Price	US\$/oz	1,400	1,400	1,400	1,400	1,400
Gold Price Realised	A\$/oz	2,050	2,064	2,079	2,088	2,090

FCF Contribution	A\$m	FY18E	FY19E	FY20E	FY21E	FY22E
<b>Mt Morgans</b>						
Revenue		-	578	571	418	434
Operating Costs		-	224	194	195	190
Sustaining Capex		-	28	35	19	16
Sustaining Exploration		-	2	2	2	2
Corp Overheads		2	4	4	4	4
<b>All-in Sustaining Margin</b>		<b>(2)</b>	<b>321</b>	<b>336</b>	<b>198</b>	<b>221</b>

Group		FY18E	FY19E	FY20E	FY21E	FY22E
<b>Gold Production</b>	<b>koz</b>	<b>-</b>	<b>280</b>	<b>275</b>	<b>200</b>	<b>208</b>
All-in Sustaining Cost	A\$/oz	-	920	856	1,098	1,024
All-in Sustaining Cost	US\$/oz	-	624	576	736	686

Operations	A\$m	FY18E	FY19E	FY20E	FY21E	FY22E
Revenue		-	578	571	418	434
All-in Sustaining Cost		2	258	235	220	213
<b>All-in Sustaining Margin</b>		<b>(2)</b>	<b>321</b>	<b>336</b>	<b>198</b>	<b>221</b>
Growth Capex		160	-	-	-	-
Growth Exploration		4	-	-	-	-
<b>All-in Margin</b>		<b>(166)</b>	<b>321</b>	<b>336</b>	<b>198</b>	<b>221</b>

Corporate	A\$m	FY18E	FY19E	FY20E	FY21E	FY22E
Cash Tax		-	-	49	78	61
Other Items		-	-	-	-	-
<b>FCF pre Debt Service</b>		<b>(166)</b>	<b>321</b>	<b>287</b>	<b>120</b>	<b>160</b>
Net Interest		(0)	5	(7)	(11)	(13)
Debt Drawdown / (Repayment)		85	(85)	-	-	-
<b>FCF post Debt Service</b>		<b>(81)</b>	<b>231</b>	<b>294</b>	<b>131</b>	<b>173</b>

New Equity/Dividends	A\$m	FY17E	FY18E	FY20E	FY21E	FY22E
Proceeds from Shares/Options		5	1	2	4	-
Dividends Paid		-	-	27	43	34
<b>Change in Cash</b>		<b>(76)</b>	<b>231</b>	<b>269</b>	<b>92</b>	<b>138</b>
<b>Cash Balance</b>		<b>17</b>	<b>249</b>	<b>517</b>	<b>609</b>	<b>747</b>

Source: IRESS, Company data, Blue Ocean estimates



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