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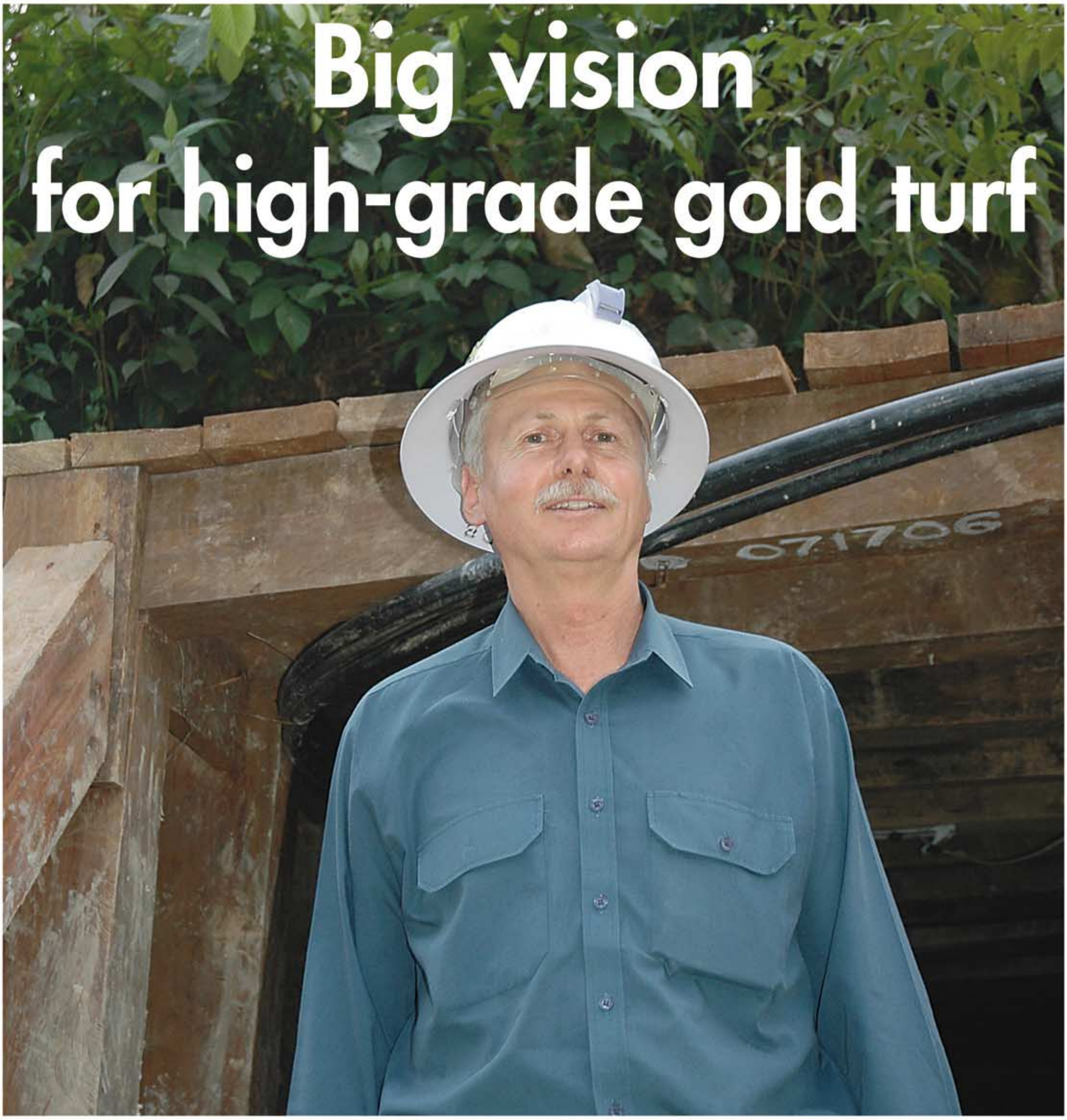

Big vision for high-grade gold turf

Medusa managing director Geoff Davis at the new Tambis gold mine

It is not often that Australian junior mining companies can demonstrate cashflow within a couple of years of listing.

And even more unusual is being in a position to target the production of 100,000 ozpa gold within four years of an ASX IPO, which raised a modest $2.5 million.

Describing the birth and development of Medusa Mining Ltd, the word "unique" comes up fairly often from managing director Geoff Davis.

Probably because it is not an everyday occurrence that a Perth-based junior has the capacity or cash to do this on home turf in Australia, let alone on the steamy islands of the Philippines.

How Medusa has managed to stitch up an enviable land package of exploration and operating mining turf on one of the world's most prospective epithermal/porphyry belts has been neither quick nor easy. As always, it has involved hard yards, good relationships and tenacity.

In the Philippines, as with many other less developed nations, these three components were crucial.

Davis is no new boy to South East Asia. His work as a geologist brought him to the Philippines and Indonesia nearly 27 years ago with BHP Billiton Ltd and on consulting contracts where he began forging local relationships. (Davis is fluent in Indonesian).

Medusa, in the process of merging with Philsaga Mining Corporation, will represent a full circle of one such relationship: the one between Davis and miner Bill Phillips, who bought the Co-O gold mine and plant in 2000 from a company which

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Geologist Ernie Apostol


Tambis mine manager Manny Barbas


Administration manager Danny Merana


Community relations manager Robin Penaloga


Dr Vic Salvado looks after the Philsaga Foundation


Chief security officer Arthur Afdal

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asked Davis to sell it.

Now it will be back in the hands of Davis and Medusa, while Phillips remains on board for the next three years.

The flagship Co-O gold mine has a resource of about 240,000oz @ 29.7 g/t but represents just one component of the bigger picture that Medusa is working on in the East Mindanao region of the Philippines. Davis reckons there could be between 1-3 moz at Co-O itself, which shows remarkable similarities to the nearby Diwalwal gold mine.

Diwalwal was discovered by prospectors about 25 years ago and since then has churned out an estimated 7-8 moz of gold. Davis likens these epithermal orebodies to the shape of a tree.

In the case of Diwalwal, the branches spread out over about 1km at surface and then coalesce a length of about 350m below surface, where the narrow veins blow out into 19m at an average grade of 3 oz/t (which translates to about 85 g/t). At Diwalwal, the orebody continued down to 600m before its grade and size dropped off.

"Co-O shows many similarities, narrow low-grade surface veins of 3-5 g/t with grade starting to pick up quite dramatically at 80m. The bottom of Co-O mine is now 270m below surface and some of the 'branches' have not yet joined up – but the main vein is around 3.5m wide, grading on average 30 g/t."

Although production is currently climbing to a rate of about 40,000 ozpa, Davis says that this will be ramped up to around 100,000 ozpa in 2007. Feed will come not only from the Co-O mine, but also from two other mines currently in development: Tambis and Sinug-Ang.

When the deal with Philsaga is consummated later this year, Medusa will have control over 700sq km of tenements over a 70km strike length of the richly endowed East Mindanao ridge and the Co-O process plant, which is pretty much at the centre of the cluster of small mines. The process plant dates back to the late 1980s and although 12km from the Co-O mine, is a formidable asset, with huge capacity to cope with low-tonnage, high-grade feed.

Another relationship which has been cemented over the project's difficult history is Davis' association with Sammy Afdal, essentially a partner to Phillips in Philsaga.

Afdal, a former regional army commander, had been involved


Ore is hand-trammed from the mine to bins, where it is loaded


Purchasing officer
Daniel Afdal


Accountant Mechel
Bongabong


Power/electrics officer
Pert Toratal


Plant manager
Rudi Vega


Safety manager
Jimmy Debuyan


Engineering and technical services manager
Alexis Afdal

with Co-O mine since 1990 when asked to join the then owners of the mine, Musselbrook Energy and Mines, to manage security. However, when Musselbrook closed the project, it left a wake of debt to various government departments, contractors, suppliers and employees.

"Very much to Sam's credit, he had the foresight to manage, on a personal basis, the Co-O project," Davis said.

"He took it upon himself to look after employees, keep the place together and make sure that it was not ransacked, kept the mill and everything else in pretty good nick.

"I think he paid for a lot of it out of his own pocket. If it wasn't for Sam's foresight to keep those assets together, there would not have been the opportunities for either Bill Phillips and, in turn, Medusa.

"Because you could not, in a narrow-veined mine, develop up enough ore to actually construct a plant from scratch, it is very hard to justify enough narrow-vein ore to build your own plant."

Davis became involved at Co-O in 1999 when he and a current Medusa associate, chief financial officer Roy Daniel, was asked by Base Metals Minerals Resource Corporation (BMMRC) to sort out the problems of the "sick entity", which included creditors of $US4.5 million, 37 pending court cases and 700 illegal miners on the Masbate gold project.

Davis said he and Afdal pulled local miners into a co-operative with BMMRC to get cash flow, in which the workers got 30% of the ore and the company 70%.

This was up and running when Davis contacted Phillips about buying the mine. Davis said the most attractive aspect of the deal was that when Phillips bought the mine in August 2000, it had everything: a functional plant, administration offices, laboratories and accommodation.

Musselbrook had spent $US22 million setting up the mine in the late '80s and Davis speculates that in today's money "you'd be spending $US45-50 million" which, in the investment climate of 2006, would be hard to justify.

The project was unique because all the onerous work of feasibility, environmental clearance, metallurgical testwork and forging relationships with the local community had already been done.

Phillips and Afdal set about getting the mine running efficiently, reinvested their profits into it, raised some money, and

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The portal at Co-O gold mine

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slowly built it up through upgrades and hiring new people.

The success of Co-O had become bigger than the strength of Phillips-Afdal partnership. During those years, Davis continued to work with Philsaga and when Medusa floated in 2003, the two companies already had JV arrangements.

In 2004 discussion shifted to Medusa acquiring Philsaga in order to move to gold producer status and "thereby gain access to very good (financial) facilities", said Davis.

Phillips and Afdal had started building their ground-holding, which was not really their forte. They were also battling the fact that when the Mining Act was changed in 1995, many tenements had objections lodged against them in East Mindanao by PICOP Resources.

At the head of PICOP was a chief executive who also had interests in mining – and was trying to attach mineral rights to his timber concession rights.

However, the separation of mineral and surface rights in the Philippines is embedded in the constitution and controlled by the Regalian Doctrine, introduced into the constitution in about 1937.

Philsaga took the issue to the mines adjudication board and won the case; the litigant then elevated it to the Court of Appeals.

Philsaga won this case too, but it had had the effect of scaring off other potential explorers and miners.

However, this "scare factor" has also worked to the advantage of Philsaga/Medusa, enabling them to pick up a very large groundholding.

The matter now rests with the Supreme Court and Davis said it was "pretty hard to predict when these things will come out, but we're optimistic that we'll be found in favour of the constitution".

The takeover of Philsaga by Medusa rests on the successful listing on the AIM board in London. Davis said Medusa was looking to raise $15 million in this listing of which $13 million would be paid to the project vendors. This would leave Medusa debt free.

Exploration in the project area would cost about $US3.6 million over the next year as Medusa aims at drilling up to 2,500m a month. This will be funded from cashflow from Co-O. Deep drilling at Co-O was scheduled to start in October.

Veteran miner Bill Phillips is Medusa's core man on the ground in the Philippines

Medusa is in a remarkably fortunate position to have, in house, eight diamond drill rigs and two underground diamond rigs.

"We're also completely self-sufficient in our truck fleet and earth-moving equipment."

Davis adds that all vehicle maintenance is done on site as well as electrical motor rewinding and the manufacture of axles, gears and other fabricated steelwork. Only skips for the shafts, headframes, ore cars and other heavy steelwork had to be sourced from elsewhere in the Philippines.

The 2004 heads of agreement signed between Philsaga and Medusa to merge the entities includes the retention of Phillips and Afdal on contract for three years. Davis said they were critical to maintain the momentum of the project.

"Nothing else on the ground will change, except Medusa will help fund the mine development and the exploration team and continue consolidating the tenements.

"We are convinced that not only do we have a great gold mine, but a whole goldfield within trucking distance of our mill.

"We're concentrating on tenements to the north and south of us, within 30-40km, bounded by the Philippines national highway. The highway has had many millions of dollars spent on it, and by Christmas this year will have been upgraded with a new concrete base and tar surface, new bridges and culverts."

Davis said it would be an "A" class highway, from which arterial roads within Medusa's tenements would be maintained by the company.

"Bill (Phillips) and Sam (Afdal) have done a fantastic job of integrating the company into the community. Officials of the Mines and Geosciences Bureau (MGB) in Manila last year told me that Philsaga was the model mining company for the Philippines. We are very well supported."

– Barry Avery, who visited the project in the Philippines

Electrician Rolando Omambac, left, with winch operator Ryan Magallanes at Tambis

Big returns from small-scale mining

Small-scale mining at Medusa Mining Ltd's East Mindanao gold project is the catch phrase.

The workforce is drawn from local artisinal miners and the operation is heavily reliant on manual labour for hand-digging and tramming of ore. The high-grade ore from the narrow ore shoots is often soft and, in the case of the developing Tambis gold mine, several hundred people will be employed when it is up and running.

Managing director Geoff Davis said that in an effort to ramp up production to the goal of 100,000 ozpa by 2007, production was starting to rise at Co-O concurrently with the development of two shafts, at 10 West and 3 West.

"During development, Co-O has been producing grades of between 8-13 g/t and the intention is to ramp up to 300 tpd at a grade of 15-20 g/t."

There's an enormous amount of artisinal mining on the western side of Mindanao island, the largest southern island in the Philippines archipelago.

Davis sees a similar output from Tambis – within six to 12 months it could be matching Co-O's 300 tpd but at a slightly lower grade. "We expect the grade to be around 10-12 g/t range, but we won't know that till we've done a reasonable amount of development work."

Davis pointed out that drill results in this kind of orebody were often misleading, and usually underestimated the grade. He cited the case of three historical drillholes at Co-O "some of which intersected less than half the grade that was mined around them" and added that there was no visible gold in the veins, as the metal contained in the ore was "micron size".

In the case of ore from Co-O, Davis said there were no metallurgical challenges and there was a 92-96% recovery from the free milling process.

After Tambis, Sinug-Ang is next development to take place. In late September, Davis said drilling and sampling results were being assessed in preparation for underground exploration. First up at Sinug-Ang will be the Banbanon prospect, where the intention is to produce ore in the second or third quarter of 2007 at a rate of about 100-150 tpd @ 15 g/t.

Further down the track, Medusa is looking at several other targets, particularly at Anoling, where work done in the 1990s indicated long vein links, "probably in the 8-12 g/t range.

"We know from local miner activity that there is a lot of gold there, as there are many shallow diggings which would not be worked unless they were getting in the order of 20 g/t.

"Around Co-O, we've been delineating a lot of veins, particularly to the south-east and they will be developed as licences are granted.

"To the west of Co-O is the Gamuton prospect which is being drilled out. Veins at surface run at 11 g/t, about a metre wide.

"Over time, we envision that the production from a number of mine sites will be quite significant and we have the aim of around 100,000 ozpa by the end of 2007.

"Because of the grades, it does not involve a large amount of ore – it is not a large material-han-

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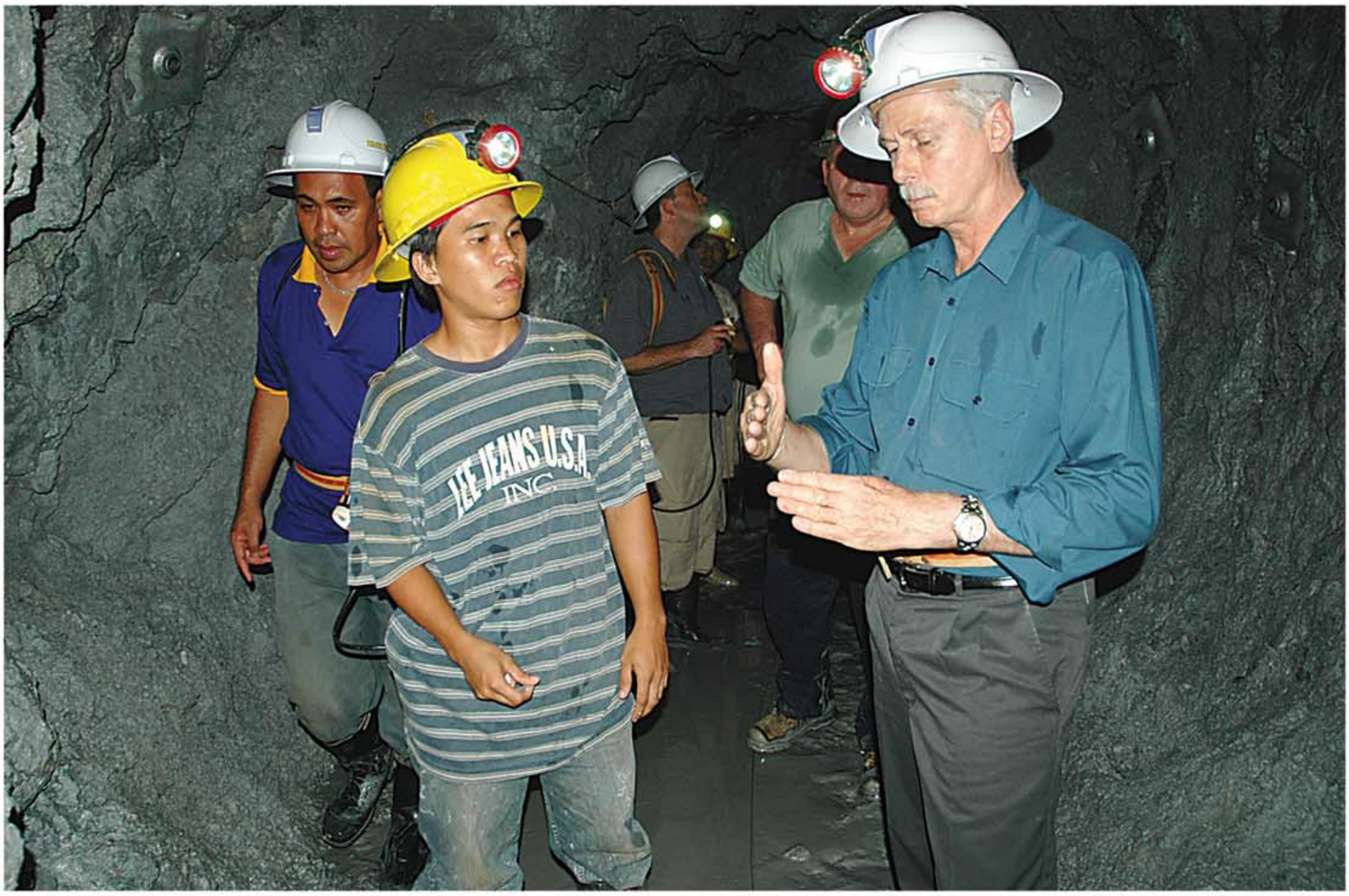

Recently graduated geologist Jaydee Amogawan, left, discusses the orebody underground at Tambis with Geoff Davis. Partially obscured behind them are, from left, Manny Barbas, Kevin Tomlinson and Bill Phillips

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dling exercise."

Davis said 100,000oz from 15 g/t ore represented only 200,000t of dirt. So with up to about 90,000t of ore eventually coming from both Co-O and Tambis, the final 20,000t would probably come from Sinug-Ang.

The Co-O plant has more than ample capacity to receive feed from the three operations.

Davis said the mill had been running with two small ball mills put in by Philsaga, which have a combined capacity of around 180-200 tpd, depending on ore hardness.

"We will maintain that circuit and have just completed refurbishing the original large ball mill, commissioned in the 1980s, which has a capacity of more than 700 tpd."

It was scheduled to start operating in September, initially on a batch basis, as it is most efficient when loaded up with 5-600t. Seven to 10 days of ore would be stockpiled before switching on the large ball mill, which required three generators to start it and two to run it.

While the two smaller ball mills can run on grid power, the large one cannot and this adds to production costs. However, Davis said this would change. Medusa had been working with local authorities who are putting in an electrical sub-station, fed by hydro-electric power, at the town of San Francisco, 25km to the north of the project area.

"This should be complete by July next year, so we can turn the big ball mill to grid power, which will cost about 12c per kwh. This will keep our production costs around $200/oz."

A 3m lift on the tailings dam wall was being finalised and another tailings dam site had been approved and would provide "a good safety margin" when production from all three mines ramped up.

While there is adequate capacity in the mill, Medusa would be looking at acquiring more tankage, and was looking to convert recovery from CIP to CIL for greater efficiency.

The gold mining operations will be funding an extensive "bigger picture" exploration drive in the region, where Medusa has seven porphyry copper-gold targets. One of these lies to the east of Co-O mine and was drilled as part of a Japanese-Filipino aid programme. The five-hole campaign included a return of 150m @ 0.4% copper, with the last 2m ending in 4.9% copper. Medusa plans to explore the target more fully next year.

Other targets for large porphyry deposits are situated near Tambis, Co-O and in the Saugon area.

– Barry Avery

Sammy Afdal, left, with Medusa chairman Kevin Tomlinson

Political background:

The Philippine Islands became a Spanish colony during the 16th century but were ceded to the US in 1898 following the Spanish-American War.

In 1935 the Philippines became a self-governing commonwealth. In 1942 the islands fell under Japanese occupation during the Second World War, and US forces and Filipinos fought together during 1944/45 to regain control. The country became independent on July 4, 1946. The country was ruled by Ferdinand Marcos for 20 years (1966-1986). Marcos' successor, Corazon Aquino, had her presidency hampered by several coup attempts. President Gloria Macapagal-Arroya was elected to a six-year term in May 2004.

Geography:

The Philippine archipelago is made up of 7,107 islands and is favourably located in relation to many of South East Asia's main water bodies: the South China Sea, Philippine Sea, Sulu Sea, Celebes Sea, and Luzon Strait.

People:

The Philippines has a population of 85 million and the HIV infection rate, estimated in 2003, was 0.1%. More than 80% of the population is Catholic; Filipino and English are the main languages. Nearly 93% of the population is literate but 40% of citizens are below the poverty datum line. Unemployment is just over 12%. The legal system is based on Spanish and Anglo-American law.

Economic overview:

The Philippines was less severely affected by the Asian financial crisis of 1998 than its neighbours, aided in part by its high level of annual remittances from overseas workers, and no sustained run-up in asset prices or foreign borrowing prior to the crisis. From a 0.6% decline in 1998, GDP expanded by 2.4% in 1999, and 4.4% in 2000, but slowed to 3.2% in 2001 in the context of a global economic slowdown, an export slump, and political and security concerns.

GDP growth accelerated to about 5% between 2002 and 2005 reflecting the continued resilience of the service sector, and improved exports and agricultural output. The implementation of the expanded VAT in November 2005 boosted confidence in the government's fiscal capacity and helped to strengthen the peso, which gained 5.7% year-on-year, making it South East Asia's best performing currency in 2005.

Investors and credit rating institutions will continue to look for effective implementation of the new VAT.