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**LKA International, Inc (OTC BB: LKAI)**
**Mine Expansion Coupled with Increased Share of Proceeds Should Drive Cash Flow Growth**
**Reason for Report:** Initiation of Coverage

**BUY**
**Recent Price: \$ 0.36**
**Market Data**

Market Capitalization (mln)	<b>\$4.58</b>
Enterprise Value (mln)	<b>\$4.34</b>
Basic Shrs Outstd (000s)	<b>12,715</b>
Fully Diluted Shrs Outstd (000s)	<b>12,715</b>
Ave. Volume (50 Day)	<b>2,000</b>
Institutional Ownership	<b>N/A</b>
Insider Ownership	<b>N/A</b>
Exchange	<b>OTC BB</b>

**Balance Sheet Data**

Shareholders' Equity (mln)	<b>\$1.91</b>
Price / Book Value	<b>2.66x</b>
Cash (000s)	<b>\$263</b>
Working Capital (000s)	<b>\$1,502</b>
Long-term Debt (000s)	<b>Nil</b>
Total Debt to Capital	<b>n.a.</b>

LKA International, Inc. is a natural resources development company that owns the Golden Wonder Mine, a producing, high-grade gold property, located near Lake City, CO. Additionally, LKA owns the Ute Ule silver mine and milling facility which are also located near Lake City, CO.

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**Summary and Investment Thesis**

- Producing Mine With Exceptional Grade, Solid Operating History**

LKA International owns the Golden Wonder Mine, near Lake City, CO. The mine has produced 115,005 oz of gold (AU) since modern operations began in 1984, with an average grade of 13.96 oz/ton AU. Grades have generally shown improvement over time, and the average grade over the last two years has been 16.09 oz/ton AU. While the Company has indicated that the existing operations have an estimated remaining life of nine months, we believe production can (and will likely) be meaningfully extended at little cost.

- LKA Moving to Expand Mine, Potentially Dramatically Increasing Reserves**

Production since 1984 has taken place on three of the six existing levels of the mine, covering approximately 350 vertical feet. LKA intends to expand the mine by putting in a drift approximately 1,050 vertical feet below the current operations and mining up towards the existing sixth level. Evidence suggests that high-grade ore continues well below the bottom of the current workings, implying a potential gold reserve of over 345,000 oz AU, assuming historical grades. Further, we believe the new drift will allow for substantially higher ore volume production than is possible at the current operations, increasing the rate of cash flow from the mine.

- Improved Terms Should Increase Cash Flow To LKA**

LKA currently receives a 10% net smelter royalty on production from existing underground workings. Under the current lease agreement with the mine operator, LKA will receive a net profit royalty of 40% on the proposed mine expansion. This should substantially increase the cash flow and profitability of the Company. Further, we believe there is room for the Company to renegotiate the lease agreement to receive at least a 50% net profit royalty. Based on the improved terms and the potential to develop significantly more productive mine workings, we calculate a value of approximately \$23.5 million for LKA International on a discounted cash flow basis. Based on this, we have assigned a price target of \$1.40 to LKAI shares.

	FY2004A	FY2005E	FY2006E	FY2007E	FY2008E
Ore Production DWT	1,260	1,200	250	1,100	3,550
Ave Grade (oz/ton)	11.36	18.57	13.96	13.96	13.96
Net Oz (@90%)	12,888	20,057	3,141	13,820	44,602
Revenues	\$ 265,757	\$ 749,200	\$ 127,418	\$ 2,620,699	\$ 8,706,688
Operating Income	\$ (131,390)	\$ 274,587	\$ (392,582)	\$ 2,100,699	\$ 8,186,688
Net Income	\$ 24,780	\$ 251,309	\$ (357,582)	\$ 1,666,936	\$ 6,140,016
EPS FY	\$ 0.00	\$ 0.02	\$ (0.02)	\$ 0.10	\$ 0.37
P/E	n.m.	19.3	n.m.	4.0	1.1

Please see analyst certification and required disclosures on page 13 of this report.

## LKA International, Inc. – Company Analysis

### Corporate Overview

LKA International, Inc (“LKA” or the “Company”) is a gold and minerals mining company based in Gig Harbor, Washington. It is listed on the Bulletin Board under the symbol LKAI. LKA owns 100% of the Golden Wonder and Ute Ule mines, both located in Colorado, USA. The Company’s primary asset is the Golden Wonder gold mine, a producing, high-grade mine located near Lake City, CO. The Company currently leases the property to AU Mining, Inc. (“AU” or the “Operator”), for which it receives a 10% net smelter royalty. Since 1984, the Golden Wonder mine has produced 115,005 oz AU from ore with an average grade of 13.96 oz/ton AU.

The Company is in the process of obtaining permits to significantly expand the Golden Wonder Mine (the “Mine Expansion Project” or “Expansion”), which it intends to do over the next 18 to 24 months. We expect the expansion to cost approximately \$3.5 million. Under the lease agreement with AU, LKA will receive at least 40% of the net profit from the Mine Expansion Project, with AU, as the Operator, receiving the balance. However, we believe the Company will be able to successfully negotiate a net profit royalty on the Mine Expansion Project of 50% to 60%.

Additionally, LKA owns the Ute Ule silver mine and milling facility, located near Lake City, CO. As no commercial activity is planned at this property at this time, we have excluded it from our analysis and valuation calculations.

### Corporate Strategy and Investment Summary

LKA’s strategy is to build upon the exceptional production record at the Golden Wonder Mine by significantly expanding the existing production zone. Evidence from the current production zone points to the existence of high-grade, mineable ore below the lower mine levels. The Company intends to open up a new drift approximately 1,050 feet below the existing workings and mine up to towards the current operations. While the nature of the Golden Wonder ore body (a system of veins) makes it difficult to calculate reliable reserve or resource estimates via traditional methods such as diamond drilling, we believe the Company’s track record and familiarity with the project, combined with substantial evidence of an existing ore body below the current operations, allow it to make reliable judgments about the viability of mining below the current workings.

From an investment point of view, the Golden Wonder Mine can be viewed as two parts:

1. The first is the existing mine operation. This area has a track record of producing exceptionally high-grade ore at a relatively low cost. Since inception, the mine has produced 115,005 ounces of gold, generating net smelter receipts of over \$31.0 million. The Company projects that the existing workings will continue to produce ore from the fifth and sixth levels of the mine for least nine months. We estimate that the existing working will produce roughly 5,415 net oz. in that time, worth approximately \$2.5 million. LKA Receives a 10% net smelter royalty from AU Mining on production from the existing levels of the Golden Wonder Mine. We believe that production could extend well beyond twelve months, although we have assumed that the existing operations will cease production in nine months in all of our calculations in order to be as conservative as possible.
2. The second part is the proposed Mine Expansion Project, which is essentially a brownfield exploration project. The Company is very familiar with the geology of the project and believes that the continuity of the Golden Wonder vein structure at the existing operations suggests that economically viable ore exists below the current workings. With no identified resources or reserves and only limited drilling and exploration, the proposed expansion must be considered speculative at this time. However, compared with other exploration projects, we believe the risk-reward profile is positively skewed by the strong operating history at the existing mine and compelling evidence that suggests economically mineable ore exists at depth. The proposed expansion plan appears relatively straightforward and, in our view, has a far greater chance of success than a typical exploration project. Instead of a 10% net smelter royalty, LKA will earn between 40% and 60% of project net profits.

The following report will explore both the current production prospects at the Golden Wonder Mine and the Mine Expansion Project in more detail. In our view, LKA International has the opportunity to meaningfully increase both its ore reserves and its level of participation from mining proceeds. LKA is on the verge of a fundamental shift in its operating and business model which we think will result in higher revenue, cash flow and, ultimately, share price. Based on our discounted cash flow analysis, we believe that the Company’s fair value is approximately US\$23.5 million and that LKA shares represent an attractive investment opportunity for investors willing to assume the risks associated with mine exploration and development. We have assigned a Buy rating on the shares and a price target of \$1.40.

## Existing Production

### Golden Wonder Mine, Lake City, CO

#### Mine Overview

The Golden Wonder Mine is a producing gold mine located in Lake City, CO. The mine began operations in 1880, but its modern production history began in 1984, with continuous production taking place since 1995. The mine is a high-grade Telluride type deposit, with veins averaging 2-4 feet in width. Over its modern production history, the mine has produced ore with an exceptional average grade of 13.96 oz/ton AU. The grade appears to increase at depth, and grades have generally improved over time. LKA International has a 100% interest in the mine after its March 2005 acquisition of Caldera Partners LP. The Company has entered into a lease agreement with AU Minerals to mine the property and receives a 10% net smelter royalty (net of certain charges) in return.

#### Property Geology

The Golden Wonder Mine is located within the San Juan Mountains of Colorado, in the southeast portion of the historic Colorado Mineral Belt (CMB). While the heyday of the CMB is long over, it was the site of some important historical gold mines, including Ouray, Silverton, Mount Sneffels and Telluride. Over 25 million ounces of gold have been mined from the area since gold was discovered there in 1867.

The geology of the mine is best described as a high-grade Telluride deposit, a common type of geology in the CMB. The rock is a kaolinized and partially silicified intrusive rhyolite, which is often brecciated. The most important regional feature is the Lake City-Uncompahgre caldera complex, into which the rhyolite intrudes.

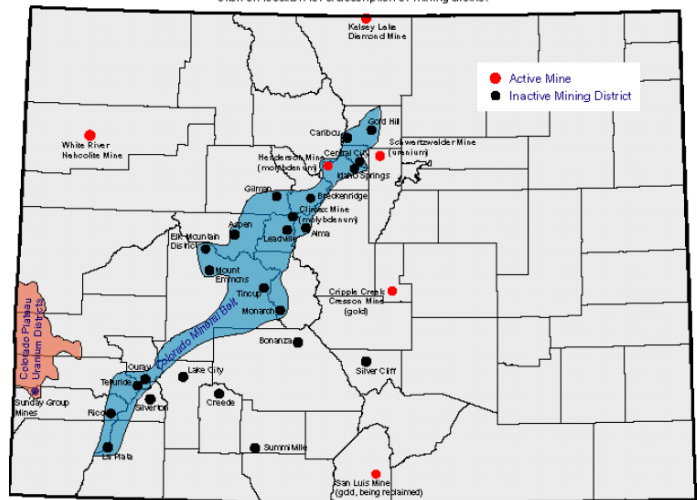
#### Current Workings Should Produce \$3.5 Million + of Ore

The Golden Wonder Mine is a currently producing mine, producing an average of 15,745 oz AU per year between 2000 and 2004. In 2005 YTD, the mine has produced 1000

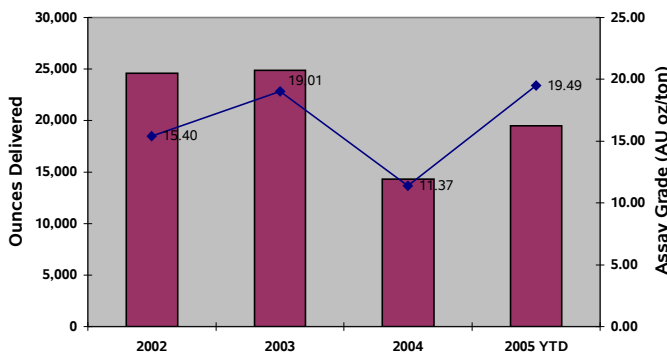
tons of ore with an average grade of 19.50 oz/ton AU, yielding 19,493 oz AU. Over the life of the mine, the ore grade has averaged 13.96 oz/ton AU. Over the last two years, the ore grade has averaged 16.09 oz/ton AU, continuing a trend of improving grade at depth. The Golden Wonder Mine has six levels, and the current Operator has systematically mined levels 3-6. Mining has concentrated on levels four and five in the past few years. LKA mined a seventh level as an exploratory effort in 1998 to probe for additional gold at depth and is not actively mined at this time, while levels 2 and 3 are largely historic workings. Ore mined from level seven contained an average grade of 18.87 oz/ton AU, well above the average grade for the mine and higher than the average grade over the past two years.

### Major Mining Districts of Colorado

(Does not include coal or construction material mines)  
Click on location for a description of mining district



Golden Wonder Mine: Gold Delivery and Assay Grades, 2002 - 2005YTD



The Golden Wonder Mine consists of a system of veins, which taken together average 2-4 feet in width. Typical of most Telluride deposits, the grade of gold varies wildly, making drilling difficult and complicating the process of determining reserves for the property. As a result, no reserve calculations have been completed for the Golden Wonder Mine. Instead, we have relied on three primary factors to infer that additional mineralization exists in the existing levels and in the area of proposed Mine Expansion Project:

- Historical production information, including improving grades at depth
- Lateral limits of the veins structure have not been

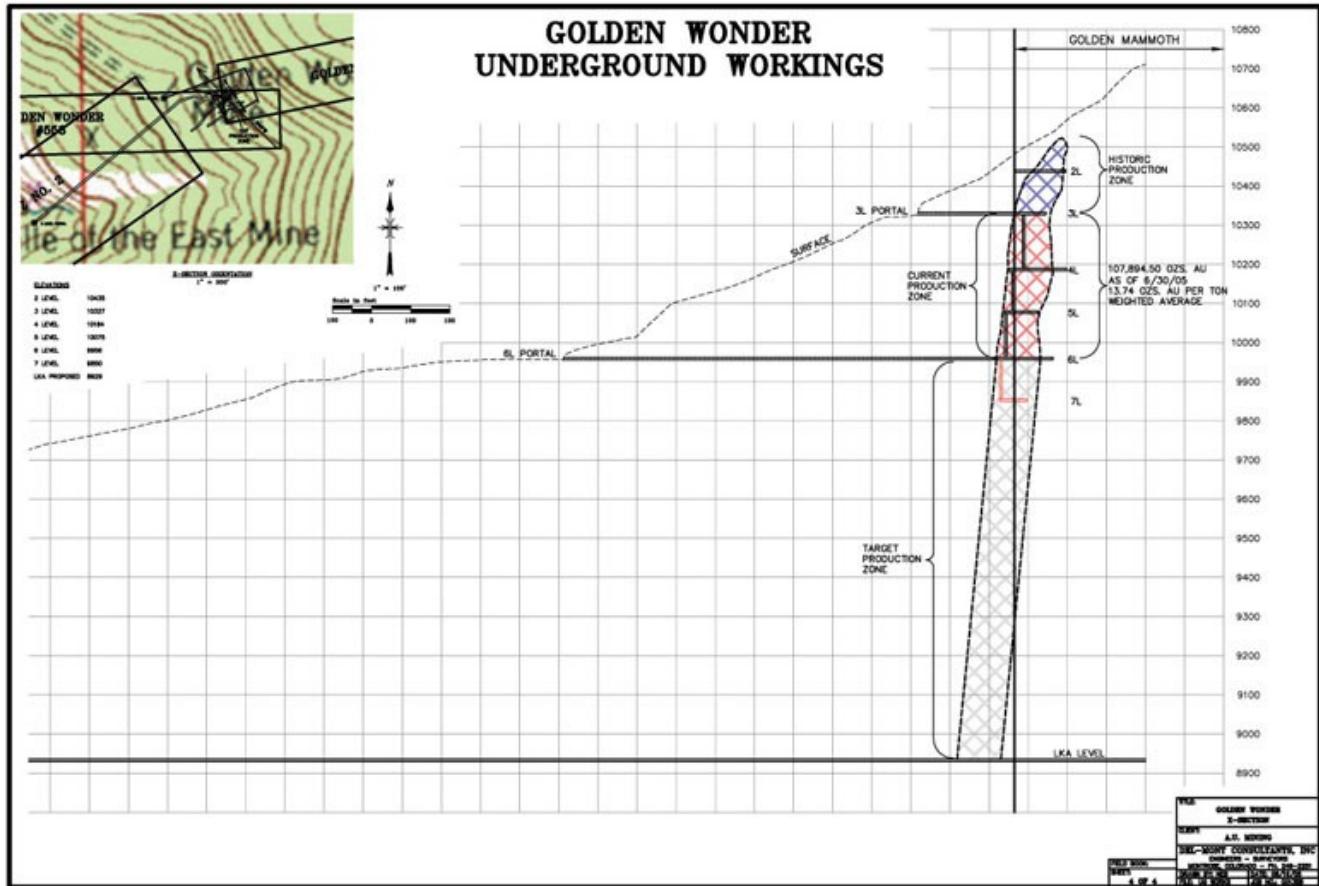
established on any of the levels

- High-grade mineralization on is present on both the sixth and seventh (the bottom two) levels of the existing operations

Production at the existing levels of the Golden Wonder Mine has been highly variable. We believe this is due to fluctuations in the mining schedule and improper incentives for timely delivery of ore by the Operator, and not the inability of the Operator to locate mineable resources.

The Company expects production at the existing operations will cease by the end of Q3'06. We project the mine will produce roughly 5,415 additional net ounces of gold in the nine months through June 2006. Using the average grade for the last two years of 15.69 oz/ton AU, the mine's net output would increase to approximately 6,385 oz Au. At an assumed gold price of \$440, that equates to FTM revenues to the mine of \$2.5-\$2.8 million.

A notable feature of the existing workings of the Golden Wonder Mine is that the grade of ore shipped has improved with each subsequent level. This is consistent with Telluride deposits and suggests that high grade gold exists below the sixth level.



Source: Company documents

**Potential Upside from Existing Operations**

While our estimates assume that the existing mine workings will cease production after Q2'06, we believe this is highly conservative. There are numerous indications LKA and its operator could continue recovering gold from the Golden Wonder Mine for some time after Q2'06. As noted above, the lateral limits of the vein structure have not been established. Additionally, on the sixth level, several additional mineralized veins have been encountered. Assay samples of up to 39 oz/ton AU have been recorded at that level, suggesting there is more economically mineable ore available. AU continues to conduct exploration activities in the fourth, fifth and six levels of the mine.

- If AU Minerals chooses to explore the existing workings at its own expense, LKA would continue to receive a 10% net smelter royalty from any additional revenues from the existing operations. If the Operator feels that more ore can be mined, we expect it will do so.
- Alternatively, if LKA undertakes any exploration to expand levels 2-6 (at LKA's expense), then the Company would be entitled to substantially better terms than they currently enjoy at the existing operations. These terms would be identical to those for the Golden Wonder expansion project, as described below.

As there is no reliable way of ascertaining whether this will occur, we have conservatively assumed that the existing six levels of the Golden Wonder Mine will cease production in mid-2006. We have not incorporated either of the above scenarios into our valuation assumptions, although we believe they represent potential near-term upside for the Company.

## Expansion Plans

### Golden Wonder Mine Expansion Project

The Company is in the process of developing the Golden Wonder Mine below the sixth level. Based on the continuity of the vein structure in the existing operation and indications that the veins continue at depth, the Company is confident that additional economically viable ore lies below the current workings. Current plans are to develop a new drift and working pad approximately 1,050 feet below the sixth level of the Golden Wonder Mine to extend the size and productivity of the Golden Wonder Mine. The Expansion is expected to cost approximately \$3.5 million and should begin producing ore by H2'07.

Due to the fractured nature of the vein system at the Golden Wonder Mine, the Company has not been able to effectively drill to establish proven and probable reserves at the Mine Expansion Project. Typical of many Telluride deposits, the Golden Wonder vein is not a single vein, but a multiple vein system comprised of a number of echelon veins, both in the vertical and horizontal direction. Previous attempts at drilling on the property have returned highly variable ore grades, with little value in terms of understanding the underlying structure. We note that the Company intends to put a drill station on the sixth level as part of the Mine Expansion Project, but this will be primarily to guide development of the new drift and to help determine the mine plan. We do not expect it to have much value with regard to determining the size or grade of the ore body. However, we believe there is ample evidence to suggest that Golden Wonder vein system continues at depth. Evidence supporting this includes:

- Grades at the exiting operations of the golden wonder continue to be strong and appear to improve at depth. The mine has produced gold since 1984, with an average grade of 13.96 oz/ton AU. Over the last five years, the average grade has been approximately 15.35 oz/ton AU. Grades continue to improve, and the average grade over the last two years is 16.09 oz/ton AU. Increasing grade at depth suggests to us that the current operations have not yet reached the bottom of the ore body.
- The Company completed exploratory mining operations on the seventh level of the mine in 1998. The Company mined 103 tons of ore from this level with an average grade of 18.87 oz/ton AU - higher than the average grade over the life of the existing operations. This implies that economically viable ore could continue to some depth below the existing operations, in our view.
- Evidence suggests that the vein structure continues at depth, with no evident pinching or tapering of veins in the lower levels of the existing mines. According to a geology report by Delmer Brown, written in 1986, "...the bottom of the Golden Wonder structure has not been penetrated. At the lowermost levels encountered (6<sup>th</sup> level), high grade gold mineralization has been found.. It is apparent that the Golden Wonder vein system continues downward to a still undetermined depth."

### ***We Calculate Potential Ore Reserves of 345,000 oz AU***

In the absence of drill results, we have estimated the potential reserve size by extrapolating from production at the existing operations. The existing operations have produced 115,005 oz. AU from levels 3-6. The existing levels span from 10,330 to 9,990 feet above sea level, approximately 350 feet. LKA intends to expand the mine by putting in an access portal at approximately 8,930 feet and mining up towards the existing mine workings. The target production zone would cover approximately 1,050 vertical feet, versus the 350 vertical feet of historical workings. Based on this information, we calculate that if the Mine Expansion Project has similar structure and grade as the existing operations, the reserve would be approximately 345,000 oz AU. At a gold price of \$430/oz, the reserve would have a gross value of over \$151 million. While this is admittedly a rather unscientific method of calculating reserves, we feel that it represents a reasonable assumption given available evidence.

**Mine Expansion Project Will Carry Significantly Better Terms for LKA**

A key feature of the Mine Expansion Project is that the terms of LKA's operating lease agreement with AU Minerals will change substantially for mining done below the existing operations. Whereas LKA currently receives a 10% net smelter royalty from existing operations, if LKA completes development of the expansion project, the terms of the lease stipulate that LKA will receive, at minimum, a 40% net profit royalty on ore removed below the sixth level of the Golden Wonder Mine. Because it is a net profit royalty versus a new smelter royalty, LKA will be responsible for its share of most mining expenses, but this nevertheless represents a significant improvement in economics for LKA. We estimate that LKA currently receives roughly \$40 per ounce of gold produced in the current workings (net of certain expenses). Under the new agreement, we estimate LKA would receive approximately \$174 per ounce of gold mined, based on a gold price of \$440 and certain additional expense assumptions.

While the terms of the lease call for LKA to receive a 40% net profit royalty from the mine expansion project, we believe that management will be able to increase the royalty percentage to at least 50%. The original agreement anticipated that the Mine Expansion Project would cost approximately \$2 million. The Company has expanded the scope of the project and development costs are now expected to be approximately \$3.5 million. Management is in discussions with AU Mining to amend the agreement and has indicated that they expect to receive as much as a 60% net income royalty from the project. Our earnings and valuation model assumes a 50% royalty. Even if the agreement is not successfully renegotiated, we note that the agreement expires in 2008, giving LKA another chance to change the terms before significant amounts of ore have been mined from the Mine Expansion Project. Given the positive relationship between the Operator and the Company, we are optimistic that the two parties will reach an agreement.

<b>Mine Expansion Program Budget:</b>	
Permits & Bonding	\$ 575,000.00
Site Prep	250,000
Drilling and Exploration	100,000
Construction Development	2,550,000
	<u>\$ 3,475,000.00</u>

The Company has budgeted \$3.475 million for the Mine Expansion Project. The expansion will include a roughly one mile long drift, designed to intercept the main vein system that is currently being mined (see diagram on page 4). In addition to accessing a potential ore body with reserves of up to 345,000 oz (as discussed above) the Mine Expansion Project will be designed to allow much higher levels of production. The mine will be designed to accommodate two shifts per day, and the current wheeled equipment at the current operations will be replaced by a high-volume, tracked haulage system. These efficiencies should allow production levels

to increase from approximately 250 DWT per quarter at the current operations to 1,000 DWT per quarter. Further, we believe that LKA will take a more active roll in the operation of the Mine Expansion Project and drive a more consistent mining schedule. This should limit the inconsistent quarterly production issues that have occurred at the existing operations. Depending on the nature of the structure, there is potential to further increase the productivity of the Mine Expansion Project. Given the uncertainty surrounding the structure of the ore body in the Mine Expansion Project, we have assumed that only the base case of 1000 DWT will be achieved.

We have attempted to be as conservative as possible in our evaluation of the Mine Expansion Project. However, we believe there is scope for upside to our projections if LKA locates a more expansive vein structure than anticipated. We believe there is a reasonable chance this could happen, given the presence of multiple vein systems at Golden Wonder, but in the absence of a reliable way to determine actual reserves, we have chosen to be as conservative as possible for valuation purposes. We believe there are several potential upside scenarios to our projections:

- Potentially longer than expected remaining life at the existing operations
- Potential for the discovery of greater than anticipated reserves at the Mine Expansion Project
- Possibly more efficient mining operations at the Mine Expansion Project than anticipated
- Additional ore could exist below the planned Mine Expansion Project
- LKA could renegotiate the lease agreement to receive a net income royalty from the mine of up to 60%; We have assumed that they will be able to achieve a 50% royalty

We believe the Mine Expansion Project represents a high-probability brownfield exploration project with potential for meaningful upside. Clearly, such an endeavor is highly risky, but in our view the risk reward profile for the Mine Expansion Project is positively skewed.

## Management Team, Financial Review & Valuation

### Management Team

Our precious metals exploration investment philosophy places heavy emphasis on the quality of management. The team at LKA International, while small, brings a great deal of mine management and minerals exploration experience to the Company. Management has a strong track record of managing the existing operations at Golden Wonder and we are confident in their ability to oversee the Mine Expansion Project.

#### Kye A. Abraham

##### *Chairman, President and Director*

Mr. Abraham has been an officer, director and shareholder of LKA International, Inc. since its formation in 1979. He has served as an officer and general partner of several LKA sponsored limited partnerships and corporations, which were engaged in several oil and gas projects in North America and various precious metals and precious gem exploration/mining operations in North America, Africa and Indonesia. Since 1982, Mr. Abraham has served as President and sole shareholder of Abraham & Co., Inc., a NASD member Broker-Dealer and Registered Investment Advisor.

#### Nanette K. Abraham

##### *Secretary and Director*

Mrs. Abraham has served as an officer and director of LKA since 1989. Additionally, Mrs. Abraham is the Secretary and a director of Abraham & Co., Inc. and is employed as an Investment Performance Analyst for the Frank Russell Company, Inc., a worldwide investment management and consulting firm headquartered in Tacoma, Washington.

#### Lance Barker

##### *President of AU Mining*

Mr. Barker is a geologist with over 25 years of exploration experience. Prior to joining Au Mining, he was employed by several companies engaged in exploration and production of precious metals and uranium in Utah, Colorado and California. He was also employed by LKA as the on-site geologist at the Golden Wonder Mine during the exploration/development of the mine in the early 1980s. Mr. Barker received a B.A. in Geology from Western State College of Colorado.

### Financial Review

LKA International is set up as a holding company structure, with 100% of its revenues consisting of royalty and operating lease payments from the Golden Wonder Mine. Expenses are limited to officer's salaries and G&A expenses. Because the Company also manages its cash balances on behalf of its shareholders, it reports significant realized and unrealized gains and losses. We expect income and expenses related to the Company's management of cash balances to become less meaningful as the Company draws down on cash to meet the budget for the Mine Expansion Project.

<b>Slected Financial Data</b>	<b>6/30/2005</b>
Cash	262,712
Investment In trading Securities	1,032,985
Total Current Assets	1,731,559
Total Assets	2,207,585
Accounts Payable	12,893
Total Current Liabilities	229,010
Shareholders Equity	2,207,585
Common Shares Outstanding	12,715,498
Shares from Offering	4,000,000
Est. Shares After Offering	16,715,498

LKA International had cash balances of \$262,712 as of June 30, 2005. Royalties receivable were \$239,373. In addition, it carried investment and trading securities of \$1,032,000.

LKA International has 12,715,498 common shares outstanding and no long-term debt.

The Company is in the process of offering for sale approximately \$3.0 million worth of LKA International shares to help fund the Mine Expansion Project. There is no indication at this time that the offering will be completed, but if it is, we estimate that it will result in an additional 4,000,000 shares. Total shares outstanding will be around 16,715,498 after the offering. Investors should keep this potential dilution

in mind. For purposes of our dilution analysis, we have assumed the offering is completed at a share price of \$0.75, which is above recent trading levels.

We note that the Company has cash balances to cover a significant portion of the Mine Expansion Project. While it will likely need to raise money to complete the project, it is not dependent on additional capital in the near-term. We believe this provides the Company with a great deal of flexibility to control dilution from the stock offering by waiting until it can be completed at an appropriate price.

### Valuation

We have valued LKA International on a discounted cash flow basis. For our model, we have assumed that the Company completes the Mine Expansion Project and successfully locates mineable reserves with grades similar to historical levels at the existing mine operations. Because of its holding company structure, LKA generates minimal depreciation or working capital, so those have been excluded from our analysis. It is possible that the Company will need to change its accounting methods to include such costs once it has completed the Mine Expansion Project. We do not think this will substantially change the valuation of the Company.

	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
EAT	\$ 251,309	\$ (357,582)	\$ 1,666,936	\$ 6,140,016	\$ 7,000,089	\$ 7,000,089	\$ 7,000,089	\$ 7,000,089	\$ 7,000,089
Capex	130,000	2,195,000	1,150,000	100,000	100,000	100,000	100,000	100,000	100,000
<b>Free Cash</b>	<b>\$ 121,309</b>	<b>\$ (2,552,582)</b>	<b>\$ 516,936</b>	<b>\$ 6,040,016</b>	<b>\$ 6,900,089</b>	<b>\$ 6,900,089</b>	<b>\$ 6,900,089</b>	<b>\$ 6,900,089</b>	<b>\$ 6,900,089</b>

WACC	DCF Value	Shares Out.	Value Per Share
8%	\$24,744,567.78	16,715,498	\$ 1.48
9%	\$23,481,862.28	16,715,498	\$ 1.40
10%	\$22,296,609.07	16,715,498	\$ 1.33

Based on our discounted cash flow analysis, we calculate a fair value for LKA International shares, after accounting for dilution from the current share offering, of approximately \$1.40. We note that we have attempted to be as conservative as possible in our assumptions. We have assumed an average spot gold price of \$440 per ounce, well below current levels, but in-line with our longer term gold price forecast. The price of gold will likely be subject to large swings in value over the life of the mine, which would have a significant effect on cash flow generation. Further, we have not assumed any further ore production from the existing mine operations and that the Mine Expansion Project will produce at historical grades of 13.96 oz/ton AU. However, recent results suggest the potential for higher grades, although it is possible that actual grades will be substantially lower than historical averages. This would significantly affect the value of LKA. Finally, we have assumed that no additional ore is mined from the existing operations after the budgeted mine life of nine months. We think this is unlikely, and that LKA and the Operator will continue to produce ore from this section of the mine within 12-18 months.

### Investment Risks

While there is evidence that the Golden Wonder structure continues downward through the proposed Mine Expansion Project, very little definitive exploration has been done to determine the extent of such an ore body. It is possible that the Company will fail to locate additional economic resources. Further, while it appears the life of the existing operations could be extended past the next nine months. However, this is contingent on locating additional mineable ore in the current active levels of the mine. There is no guarantee that this will occur, or that either the Company or AU Minerals will attempt to locate such ore.

While there is substantial evidence, in our view, that mineable gold exists below the sixth level of the current operations, there is no reliable evidence to suggest how far the vein system extends below the existing operations. There is the possibility that even if gold exists, it will not extend 1,050 feet below the existing operations to the planned drift. This could lead to the Company spending substantial funds, only to find a "dry hole." We cannot accurately gauge this risk at this time.

LKA International and AU Mining depend on one customer, Barrick-Goldstrike, to purchase ore from the Golden Wonder Mine. Barrick-Goldstrike is under no obligation to buy ore from LKA International and may stop doing so at any time. We note that a former customer, ASARCO, ceased taking ore from LKA International in 2000, forcing the mine to cease production for over a year. What ore was mined during that time had to be shipped a great distance to an interim customer. Should Barrick-Goldstrike stop taking LKA's ore for any reason, it would have a substantial negative effect on the Company's business. Relations between LKA and Barrick-Goldstrike appear solid and we do not anticipate the relationship coming to an end.

The Company is also largely dependent on AU Mining to operate the mine under the terms of an existing lease agreement. This agreement expires in 2008. Should AU Mining cease doing business with LKA International, the Company would have to locate an alternative operator. There is no assurance that it will be able to do this. Relations between AU Mining and LKA International appear to be good, and the Company believes it could locate a new operator if necessary.

The political and regulatory environment in Colorado is generally considered to be a difficult one for mining companies. LKA could face significant legal and regulatory hurdles during the permitting process for the Mine Expansion Project. The risk of this is increased, in our view, due to the proximity of the mine to nearby lake San Cristobal and the Gunnison River, as well as and the need to tunnel the access road under a highway. The Company is in consultation with state officials and intends to start the official permitting process in October 2005.

The Federal Bureau of Land Management has indicated that LKA International may be responsible for certain environmental clean-up activities on its property related to past mining activities. The clean-up costs have been calculated to be as much as

\$4,317,000 although LKA is negotiating the extent of their responsibility for the cleanup and costs. The timing and the ultimate costs of such cleanup have yet to be determined, but could have substantial impact on the Company's ability to operate as a going concern.

The stock is currently very thinly traded, with an average daily volume over the last 50 days of 2,000 shares. Unless trading volume improves, investors will likely find it difficult to enter or exit positions in a timely manner. As a function of low trading volume, LKA International shares have shown greater than average volatility.

## **Conclusion**

The value of LKA International's shares lies in the successful completion of the Mine Expansion Project. As we have discussed, we view the Expansion as a brownfield exploration project, albeit one with a better than average chance of success. We believe the evidence points to the continuation of the Golden Wonder vein system well below the existing operations at the Golden Wonder Mine. Further, additional revenue could come from extending the productive life of the existing operations. Based on our discounted cash flow analysis, we believe the Company has a fair value of approximately \$23.5 million, or \$1.40 per share. Consequently, we have assigned a Buy rating to the Company's shares.



## LKA International, Inc. (LKAI) - Revenue Model

FYE December	FY 2003A	1Q04	2Q04	3Q04	4Q04	FY2004A	1Q05	2Q05	3Q05E	4Q05E	FY 2005E	FY 2006E	FY 2007E	FY 2008E	FY 2009E
<b>Production</b>															
Ore Production (DWT)	1,308	243	453	283	281	1,260	280	337	383	200	1,200	250	1,100	3,550	4,000
Grade	19.01	4.37	9.39	14.63	17.34	11.36	20.52	19.70	18.57	13.96	18.57	13.96	13.96	13.96	13.96
Ounces Au	24,864	1,063	4,252	4,135	4,871	14,321	5,747	6,636	7,110	2,792	22,285	3,490	15,356	49,558	55,840
Net Ounces Au @ 90%	22,378	956	3,827	3,721	4,383	12,888	5,172	5,972	6,399	2,513	20,057	3,141	13,820	44,602	50,256
Wtr. Ave. Settlement Price Per Ounce	\$ 351.16	\$ 404.88	\$ 396.72	\$ 405.25	\$ 439.38	\$ 414.30	\$ 423.35	\$ 421.87	\$ 437.93	\$ 440.00	\$ 429.65	\$ 440.00	\$ 440.00	\$ 440.00	\$ 440.00
<b>Project Gross Revenue</b>	<b>\$ 7,858,144</b>	<b>\$ 387,223</b>	<b>\$ 1,518,319</b>	<b>\$ 1,507,964</b>	<b>\$ 1,926,009</b>	<b>\$ 5,338,515</b>	<b>\$ 2,189,692</b>	<b>\$ 2,519,436</b>	<b>\$ 2,802,470</b>	<b>\$ 1,105,632</b>	<b>\$ 8,617,230</b>	<b>\$ 1,382,040</b>	<b>\$ 6,080,976</b>	<b>\$ 19,624,968</b>	<b>\$ 22,112,640</b>
<b>Expenses Attributable to LKA</b>															
<b>Mining</b>															
Processing/Smelting (\$250/DWT)	327,052	40,871	113,217	70,652	70,224	294,964	70,000	84,225	95,750	50,000	299,975	62,500	275,000	887,500	1,000,000
Shipping/Assays/Samples +2% per Qtr.	111,812	20,504	51,713	25,160	28,340	125,718	28,490	41,481	39,847	20,808	130,626	26,010	114,444	369,342	416,160
Gen. & Admin. (Project Level)													165,000	180,000	180,000
Production Taxes (Production)															
<b>Project Net Revenue</b>	<b>\$ 7,419,280</b>	<b>\$ 325,849</b>	<b>\$ 1,353,388</b>	<b>\$ 1,412,152</b>	<b>\$ 1,827,445</b>	<b>\$ 4,918,833</b>	<b>\$ 2,091,202</b>	<b>\$ 2,393,730</b>	<b>\$ 2,627,638</b>	<b>\$ 1,019,345</b>	<b>\$ 8,131,915</b>	<b>\$ 1,274,181</b>	<b>\$ 5,211,398</b>	<b>\$ 17,413,376</b>	<b>\$ 19,706,903</b>
Royalty/Share of Net Revs (%)	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%	50%	50%	50%
Royalty (\$)	\$ 741,928	\$ 32,585	\$ 135,339	\$ 141,215	\$ 182,745	\$ 491,883	\$ 209,120	\$ 239,373	\$ 262,764	\$ 101,935	\$ 813,191	\$ 127,418	\$ 2,620,699	\$ 8,706,688	\$ 9,853,452
LKA Portion (%)	n.a.	54%	54%	54%	54%	54%	69%	100%	100%	100%	92%	100%	100%	100%	100%
<b>LKA Royalty Income</b>	<b>n.a.</b>	<b>\$ 17,628</b>	<b>\$ 73,218</b>	<b>\$ 76,397</b>	<b>\$ 98,513</b>	<b>\$ 265,757</b>	<b>\$ 145,129</b>	<b>\$ 239,373</b>	<b>\$ 262,764</b>	<b>\$ 101,935</b>	<b>\$ 749,200</b>	<b>\$ 127,418</b>	<b>\$ 2,620,699</b>	<b>\$ 8,706,688</b>	<b>\$ 9,853,452</b>

## LKA International, Inc. (LKAI) - Statement of Profit and Loss

FYE December	FY 2003A	1Q04	2Q04	3Q04	4Q04	FY2004A	1Q05	2Q05	3Q05E	4Q05E	FY 2005E	FY 2006E	FY 2007E	FY 2008E	FY 2009E
<b>Revenue</b>															
Royalty Income	\$ 293,270	\$ 17,628	\$ 73,218	\$ 76,398	\$ 98,513	\$ 265,757	\$ 145,129	\$ 239,373	\$ 262,764	\$ 101,935	\$ 749,200	\$ 127,418	\$ 2,620,699	\$ 8,706,688	\$ 9,853,452
<b>Total revenue</b>	<b>\$ 293,270</b>	<b>\$ 17,628</b>	<b>\$ 73,218</b>	<b>\$ 76,398</b>	<b>\$ 98,513</b>	<b>\$ 265,757</b>	<b>\$ 145,129</b>	<b>\$ 239,373</b>	<b>\$ 262,764</b>	<b>\$ 101,935</b>	<b>\$ 749,200</b>	<b>\$ 127,418</b>	<b>\$ 2,620,699</b>	<b>\$ 8,706,688</b>	<b>\$ 9,853,452</b>
<b>Operating Expenses</b>															
Officer Salaries and Bonus	68,000	16,230	16,230	136,230	16,230	184,920	20,820	55,000	55,000	55,000	185,820	220,000	220,000	220,000	220,000
G&A	87,127	33,415	49,868	53,052	75,892	212,227	62,735	76,058	75,000	75,000	288,793	300,000	300,000	300,000	300,000
<b>Total operating expenses</b>	<b>\$ 155,127</b>	<b>\$ 49,645</b>	<b>\$ 66,098</b>	<b>\$ 189,282</b>	<b>\$ 92,122</b>	<b>\$ 397,147</b>	<b>\$ 83,555</b>	<b>\$ 131,058</b>	<b>\$ 130,000</b>	<b>\$ 130,000</b>	<b>\$ 474,613</b>	<b>\$ 520,000</b>	<b>\$ 520,000</b>	<b>\$ 520,000</b>	<b>\$ 520,000</b>
<b>Operating Income (Loss)</b>	<b>\$ 138,143</b>	<b>\$ (32,017)</b>	<b>\$ 7,120</b>	<b>\$ (112,884)</b>	<b>\$ 6,391</b>	<b>\$ (131,390)</b>	<b>\$ 61,574</b>	<b>\$ 108,315</b>	<b>\$ 132,764</b>	<b>\$ (28,065)</b>	<b>\$ 274,587</b>	<b>\$ (392,582)</b>	<b>\$ 2,100,699</b>	<b>\$ 8,186,688</b>	<b>\$ 9,333,452</b>
Investment/Other Income, Net	285,325	(4,095)	(36,942)	37,562	177,952	174,477	22,991	7,457	20,000	20,000	70,448	35,000	-	-	-
<b>Pre-Tax Income</b>	<b>\$ 423,468</b>	<b>\$ (36,112)</b>	<b>\$ (29,822)</b>	<b>\$ (75,322)</b>	<b>\$ 184,343</b>	<b>\$ 43,087</b>	<b>\$ 84,565</b>	<b>\$ 115,772</b>	<b>\$ 152,764</b>	<b>\$ (8,065)</b>	<b>\$ 345,035</b>	<b>\$ (357,582)</b>	<b>\$ 2,100,699</b>	<b>\$ 8,186,688</b>	<b>\$ 9,333,452</b>
Income Tax Expense	-	-	-	-	18,307	18,307	23,475	32,060	38,191	-	93,726	-	433,763	2,046,672	2,333,363
Rate (%)	n.a.	n.a.	n.a.	n.a.	9.9%	42.5%	27.8%	27.7%	25.0%	0.0%	27.2%	0.0%	20.6%	25.0%	25.0%
<b>Net Income</b>	<b>\$ 423,468</b>	<b>\$ (36,112)</b>	<b>\$ (29,822)</b>	<b>\$ (75,322)</b>	<b>\$ 166,036</b>	<b>\$ 24,780</b>	<b>\$ 61,090</b>	<b>\$ 83,712</b>	<b>\$ 114,573</b>	<b>\$ (8,065)</b>	<b>\$ 251,309</b>	<b>\$ (357,582)</b>	<b>\$ 1,666,936</b>	<b>\$ 6,140,016</b>	<b>\$ 7,000,089</b>
<b>Basic/Diluted EPS</b>	<b>\$ 0.07</b>	<b>\$ (0.01)</b>	<b>\$ (0.01)</b>	<b>\$ (0.01)</b>	<b>\$ 0.03</b>	<b>\$ 0.00</b>	<b>\$ 0.01</b>	<b>\$ 0.01</b>	<b>\$ 0.01</b>	<b>\$ (0.00)</b>	<b>\$ 0.02</b>	<b>\$ (0.02)</b>	<b>\$ 0.10</b>	<b>\$ 0.37</b>	<b>\$ 0.42</b>
Shares Out (Basic & Diluted)	6,250,993	5,281,456	5,281,456	5,835,804	5,835,804	5,673,237	8,426,137	12,715,498	12,715,498	14,715,498	12,143,158	16,715,498	16,715,498	16,715,498	16,715,498

## LKA International, Inc. (LKAI) - Balance Sheet

	December 31, <u>2004</u>	June 30, <u>2005</u>
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash	\$ 411,960	\$ 262,712
Royalties receivable	-	239,373
Due from affiliates	64,134	64,271
Prepaid expenses	-	15,000
Refundable Deposit		
Notes receivable	110,164	110,164
Accrued interest receivable	410	5,054
Margin trading account	63,308	-
Investment in trading securities	829,498	1,032,985
Deferred tax asset	-	2,000
<b>Total Current Assets</b>	<b>\$ 1,479,474</b>	<b>\$ 1,731,559</b>
<b>Fixed Assets</b>		
Land and mining claims	272,714	445,501
Accumulated depreciation	(29,587)	(33,310)
<b>Total Fixed Assets</b>	<b>\$ 243,127</b>	<b>\$ 412,191</b>
<b>Other Assets</b>		
Reclamation bonds	63,835	63,835
Deferred tax asset	5,100	-
<b>Total Other Assets</b>	<b>\$ 68,935</b>	<b>\$ 63,835</b>
<b>TOTAL ASSETS</b>	<b>\$ 1,791,536</b>	<b>\$ 2,207,585</b>
<b>LIABILITIES</b>		
<b>Current Liabilities:</b>		
Accounts payable	\$ 51,821	\$ 12,893
Note payable	10,000	10,000
Notes payable - related party	62,803	62,803
Accrued interest - related party	42,068	45,177
Margin trading account	-	23,561
Income taxes payable	23,407	74,576
Due to related party	907,531	-
<b>Total Current Liabilities</b>	<b>\$ 1,097,630</b>	<b>\$ 229,010</b>
<b>Long-Term Liabilities:</b>		
Asset retirement obligation	58,449	59,243
Deferred tax liability	-	6,700
<b>Total Long-Term Liabilities</b>	<b>\$ 58,449</b>	<b>\$ 65,943</b>
<b>TOTAL LIABILITIES</b>	<b>\$ 1,156,079</b>	<b>\$ 294,953</b>
<b>Shareholders' Equity</b>		
Common stock	6,281	12,715
Additional paid-in capital	5,516,956	6,642,895
Accumulated deficit	(4,887,780)	(4,742,978)
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>\$ 635,457</b>	<b>\$ 1,912,632</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS'</b>	<b>\$ 1,791,536</b>	<b>\$ 2,207,585</b>

## Our Rating System

We rate enrolled companies based on the appreciation potential we believe their shares represent. The performance of those companies rated “Speculative Buy” or “Strong Speculative Buy” are often highly dependent on some future event, such as FDA drug approval or the development of a new key technology.

### Explanation of Ratings Issued by Harbinger Research

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<b>STRONG BUY</b>	We believe the enrolled company will appreciate more than 20% relative to the general market for U.S. equities during the next 12 to 24 months.
<b>BUY</b>	We believe the enrolled company will appreciate more than 10% relative to the general market for U.S. equities during the next 12 to 24 months.
<b>STRONG SPECULATIVE BUY</b>	We believe the enrolled company could appreciate more than 20% relative to the general market for U.S. equities during the next 12 to 24 months, if certain assumptions about the future prove to be correct.
<b>SPECULATIVE BUY</b>	We believe the enrolled company could appreciate more than 10% relative to the general market for U.S. equities during the next 12 to 24 months, if certain assumptions about the future prove to be correct.
<b>NEUTRAL</b>	We expect the enrolled company to trade between -10% and +10% relative to the general market for U.S. equities during the following 12 to 24 months.
<b>SELL</b>	We expect the enrolled company to underperform the general market for U.S. equities by more than 10% during the following 12 to 24 months.

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I, Derrick M. Irwin, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the recommendations or views expressed in this research report.

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### Analyst Background

#### **Derrick M. Irwin, CFA, Senior Research Analyst Precious Metals Mining**

Derrick Irwin, CFA, brings Harbinger Research over a decade of Wall Street experience. Most recently, he served as the lead Retail and Consumer Products analyst at Advest, a well-known boutique investment bank. Prior to his time at Advest, he worked in the investment management group of Goldman Sachs, managing investment portfolios for Goldman's ultra high net worth clients. Derrick's Wall Street experience also includes time at Merrill Lynch, where he held various professional positions within Merrill's Southeast Asian investment banking group.

Additionally, Derrick has worked with mining companies in North America, South America and Australia, and has also had significant exposure to the South African gold mining sector. He holds an MBA from the Wharton School of the University of Pennsylvania, and dual undergraduate degrees in economics and geology from Colgate University. Derrick is a CFA Charterholder.

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