Australian Gold Fund

Performance Report

For Quarter Ending 31st December 2019

Summary

The December 2019 quarter is the first full quarter for the Australian Gold Fund. During this quarter, the fund delivered a time-weighted rate of return of -1.33%. This compares to the ASX All Ordinaries Gold Index quarterly return of -7.54%, the GDX (in USD) returning 10.37% and the GDXJ (In USD) returning 17.04%. The relative performances of the indices need to be placed into context by considering the return over 2019 with the ASX All Ordinaries Gold Index returning 26.81%, the GDX (in USD) returning 40.43% and the GDXJ (in USD) returning 39.79%.

Since 23rd August 2019 to the end of the year, the Australian Gold Fund delivered a -2.33% return. Over the same period, the ASX All Ordinaries Gold Index returned -10.67%, the GDX returned 2.72% and the GDXJ returned 7.02%.

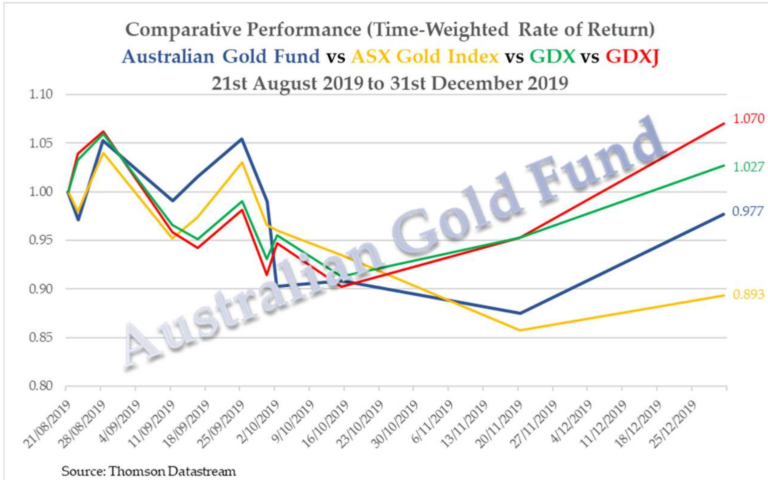
The fund's composition as at 31st December 2019 is given in the table below:

	% Portfolio by Market Value	Range
Cash	4.1%	2-10%
Major and Large Producers	10.9%	0-20%
Mid-Tier Producers	61.0%	0-60%
Junior and Micro Producers	20.9%	0-60%
Developers and Explorers	1.8%	0-10%
Precious Metals ETF	1.3%	0-30%

The Top 5 holdings is given in the table below:

Top 5 Holdings
Red 5 Limited
Resolute Mining
Ramelius Resources
Westgold Resources
Silver Lake Resources

The relative performance of the fund against the ASX Gold Mining Index (XGD), the VanEck Vectors Gold Miners Exchange Traded Fund (GDX) and the VanEck Vectors Junior Gold Miners Exchange Traded Fund (GDXJ) during this quarter is given in the figure below:



As foreshadowed in the previous quarter, the gold mining companies indeed saw some significant downturn during the quarter. The sharpest declines occurred on 14th October and 8th November when the ASX All Ordinaries Gold Index fell by more than 5%. The index bottomed on 13th December and then began its gradual ascent into the end of the year. Likewise, the Australian Gold Fund bottomed on the same day but the recovery was more substantial as a result of the fund's stronger bias towards mid-tier companies that performed more strongly compared to the other classes.

This quarter saw a number of major acquisitions including the acquisition of Newmont GoldCorp's Kalgoorlie Super Pit mine by Northern Star Mines and Saracen Mineral Holdings, Kirkland Lake Gold's takeover of Detour Gold, Evolution Mining purchasing the Red Lake Gold mine from Newmont GoldCorp, the completion of Silver Lake Resources' takeover of Egan Street and Northern Star Mines' takeover of Echo Resources. These purchases during a normally weak period for gold mining companies reflect the bullishness of the larger producers and the potential for future growth. Our fund is exposed to these activities, except for Kirkland Lake Gold, and we have positioned our portfolio to more exposure to these large producers after selling some of our mid-tier companies. We also added our exposure to Oceanagold over the quarter given that the substantial price decline in the wake of the Didipio mine suspension made us believe that the company is undervalued in spite of this disappointing development in the Philippines.

We found it difficult to sell down some of our mid-tier company holdings including Perseus Mining, Ramelius Resources and Alacer Gold as they have been stellar performers and their potential seems to suggest they may rise even more. However, we have exceeded our own mandated exposure to the mid-tier producers and it would not be tenable to continue this. Saracen Mineral Holdings was reclassified to a large mining company during the quarter, so this reduced the pressure to sell. On the junior and mini producers, Millennium Minerals have entered into voluntary administration so our holdings have similarly been suspended from trading and our largest holding Red 5 dipped to 23c during the quarter but made a strong recovery in the last three weeks of December to finish up at 33c.

Our fund did not make execute any transactions on developers and explorers during the quarter.

Looking into the next three months, we expect the seasonal strength for gold in January and February may provide opportunities to deliver substantial returns on our holdings. We are cautious though about the instability of geopolitical situations possibly escalating the gold price, but any signs of stabilising the tension could trigger a sharp sell-off. However, we are of the view that this year will see the Federal Reserve and other central banks continuing to adopt an accommodative monetary policy with further currency printing in light of weaker economic fundamentals and worries that any tightening may spark a market rout. This will continue to be bullish for precious metals and gold mining companies, in our view. However, we believe that as the valuation becomes stretched due to an expected exuberance of investors into the gold mining industry, there will be a line drawn between reliable and well-run mining companies from those that are either poorly managed or are speculative ventures that are far away from delivering any revenue from production.

Valuation Thesis

The gold mining companies are classified based on their production level on an annual basis. The classification used in this report is as follows – **A** (major producer – 1Moz p.a. or more), **B** (large producer – 0.5-1Moz p.a.), **C** (mid-tier producer – 150 000-500 000oz p.a.), **D** (junior producer – 50 000-150 000oz p.a.) and **E** (micro producer – less than 50 000oz p.a.).

We use the **EV/AISC-Adjusted Annual Production** as a *comparative measure* to evaluate the companies we study. This metric is able to standardise the production and production costs and hence allow for comparison across all classes of producers. The **Enterprise Value** is the sum of the market value of equity (stock price multiplied by number of issued stocks) and net debt (total borrowings less cash and gold bullion, but excluding gold in circuit and ore stockpiles). The **AISC-Adjusted Annual Production** is measure whereby the annual production of gold per oz is divided by the AISC adjusted by a factor of 1 000. The intuition behind this measure is to value the company by taking into account annual production but giving favourable treatment for lower AISC and penalising for higher AISC. The factor of 1 000 is arbitrarily chosen. As an illustration, if a company produces 250 000oz p.a. at AISC of $1 250, the AISC-adjusted production is 200 000.

The **Price Range** determines a reasonable range for which the company stock price should be trading at. This range is relatively wide as it considers the *margin of safety*. A company whose stock price is currently outside the fair value range is significantly over or undervalued and investors should look more deeply into the company's operations, financial performance and recent market announcements. This range should not be taken as the sole driver for investment decisions, but as a starting point for further research to identify the potential causes for the current stock price.

Given the rise in gold price in the recent three months, we see reason to re-rate the gold mining companies' valuation metrics upwards to reflect their improving profitability as well as increased enthusiasm from investors. As a rough guide, the fair value ranges for different mining company classes are as follows:

***Major and Large Companies** - $8 000-$11 000/oz*

***Mid-Tier Companies** - $3 000-$6 000/oz*

***Micro and Junior Companies** - $1 500-$2 500/oz*

The metric is by no means perfect and other factors should be considered including reserve and resource life, projected production volume and costs, management quality and geographic location. Further, it is of a retrospective nature, focusing on past performance and this may not be a good indicator for future performance.

Glossary

The **All-in Sustaining Cost (AISC)** is a measure adopted by the World Gold Council as a standardised measure of production costs. This cost includes typically the **Cash Cost** associated with the direct production (extraction, transportation, processing and refining costs, staff salary and wages and relevant corporate costs) as well as **Sustaining Expenditure** that may include maintenance of mine equipment and infrastructure, insurance and administration costs over its production life. Companies may still have discretion in apportioning their expenses.

The **Net Cash/Debt** is the net amount of cash and bullion the company holds after their borrowings and interest-bearing debt are paid. This represents the liquidity position of the company, although this measure does not consider whether the debt is current (due within the next twelve months) or not. A company in a significant net debt position is owing more than they currently have in cash and bullion, which may potentially put them in financial distress if the debt is due soon.

The **Net Cashflow from Operations Excluding Maintenance Capital Expenditure** measures to what extent the company can generate cashflows from its operations after paying for its operating costs as well as Cash Paid for Purchases of Property, Plant and Equipment and the Cash Paid for Development Expenditure in the Investing Cashflows section of the Statement of Cash Flows. It does not include Cash Paid for Exploration and Evaluation, which is assumed to be growth capital expenditure. This is by no means a stable and comparable measure as different companies may have discretionary interpretation of what constitutes as Operating Activities and Investing Activities or Development, Exploration and Evaluation expenditures.

Disclaimer

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