Australian Gold Fund

Performance Report

For Quarter Ending 30th September 2019

Amended 2nd January 2020

Summary

The Australian Gold Fund was officially established as a separate entity on 22nd July 2019. Stock transfers from the fund's shareholders first occurred on 23rd August 2019. Thus, the September quarter's performance is a very short one and may not provide too much of an indicator of the fund's performance, especially given the timing of the inauguration of the fund at a time when the gold mining companies reached a peak.

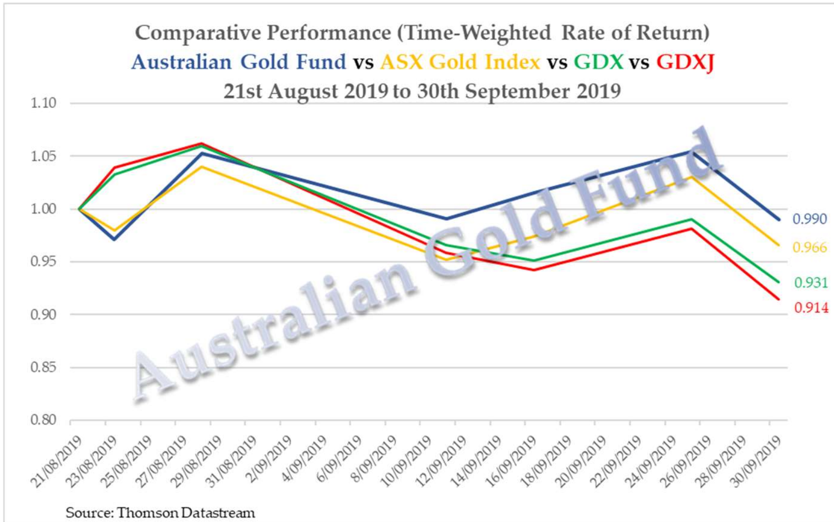
The fund's composition as at 30th September 2019 is given in the table below:

	% Portfolio by Market Value	Range
Cash	0.4%	2-10%
Major Producer	0.0%	0-20%
Large Producer	6.1%	0-40%
Mid-Tier Producer	69.2%	0-60%
Junior Producer	19.3%	0-60%
Micro Producer	2.2%	0-20%
Late-Stage Developer	0.4%	0-10%
Early-Stage Developer	1.0%	0-10%
Explorer	0.0%	0-5%
Precious Metals ETF	1.4%	0-30%

The Top 5 holdings is given in the table below:

Top 5 Holdings
Resolute Mining
Red 5 Limited
Ramelius Resources
Westgold Resources
Dacian Gold

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:



Our end of quarter cash position is well below our range as we chose to retain virtually fully invested. We hold to the view that the gold-oil ratio has been averaging over 25, suggesting that operating conditions will continue to be favourable for gold mining companies.

Over the six-week period relevant to this quarter, the gold mining companies gradually began to retreat after reaching a peak on 4th September. Our fund took this opportunity to sell some of our mid-tier producers during September, but only modestly so. We retain a substantial amount in our portfolio, as indicated by our overweight position on mid-tier producers. Among all the gold mining company categories, we see the greatest potential in the medium to long-term with mid-tier producers. Several of them have made acquisitions over the last six months to expand their production as well as their resource base, some of them being better timed and well-priced than others. We also see companies like Perseus Mining, Ramelius Resources and Regis Resources building mines with a view to expand their production.

Our exposure to large gold producers has been substantially underweight owing to the meteoric rise of these companies over the last year. All of these companies are approaching or already are deemed overvalued based on our valuation metrics, although we recognise their potential to continue to grow in the future given their operational scope and acquisitions of other mining companies and mine properties. Should the prices further retreat, we may reallocate some of our holdings to these large producers.

On the other hand, we have an underweight exposure to junior gold producers relative to mid-tier gold producers as many of these companies have been underperforming or are facing operational issues. The exception is Red 5 Limited that has been among the top 5 best performing gold mining companies by stock price returns over the last 12 months, which remain as our largest portfolio holding. We see a promising future in light of their significant discovery of reserves and resources in the King of the Hills Mine. We do anticipate that the price will remain rangebound for a while given that their processing plant development is expected to commence late 2020 and their 2020 full-year production is a moderate increase to the 2019 results.

Our exposure to developers and explorers remains minimal as we hold to the view that while some promising players exist, it is a very high risk territory. We do hold a small stake in Kingsgate Consolidated as we anticipate a positive outcome regarding their court case arbitration against the Thai government for their suspension of the Chatree mine in Thailand in 2016. We also have small stakes in two mining explorers that have delivered some promising gold intercepts in their drilling campaign.

The quarter ending 31st December is expected to be see further declines for gold mining companies due to a combination of selling associated with paying taxes in Australia as well as tax loss selling in the northern hemisphere as the financial year ends. We expect that the gold price will remain steady but will weaken as this is typically the time of the year when precious metal prices take a breather after the summer rally. Being close to fully invested, our fund will make tactical adjustments to our holdings.

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