Australian Gold Fund

Performance Report

For Quarter Ending 30th September 2020

Summary

Fund Performance Statistics				
	Australian Gold Fund	ASX Gold Index (XGD)	Van Eck GDX	Van Eck GDXJ
Quarter Performance	10.12%	2.18%	6.76%	11.66%
Quarter Volatility (%)	34.97%	32.89%	48.23%	41.34%
Year to Date Performance	26.23%	23.89%	33.74%	30.98%
Year to Date Volatility (%)	45.74%	50.11%	79.73%	64.33%
Performance Since Inception	31.33%	10.68%	37.39%	40.17%
Volatility Since Inception (%)	42.80%	44.21%	67.86%	55.01%
Quarter % Days Outperform XGD	60.61%			
Year to Date % Days Outperform	50.00%			
% Days Outperform Since Inception	52.58%			

The September quarter saw the gold mining industry continue to boom until late September when the gold price headed down and the gold mining company stock prices head down rather sharply. Despite that, the industry ended the quarter higher, though the gains were slimmer. The fund delivered a time-weighted rate of return of 10.1%, outperforming comfortably the ASX Gold Index, marginally against the Van Eck GDX while underperforming slightly against the Van Eck GDXJ. On a risk-adjusted performance after taking into account the volatility, our fund outperformed against these three indices. We are pleased to announce that our fund outperformed against the ASX Gold Index on more than 60% of the trading days during the quarter, demonstrating our ability to identify better quality assets and allocate our funds to them in a timely manner. Since inception, our fund has delivered 31.3% returns at an annualised volatility of 42.8% and being able to outperform the ASX Gold Index on 52.6% of the trading days. While we trail behind the Van Eck indices in terms of returns, we delivered superior risk-adjusted returns.

During the quarter, the gold price in US dollar terms broke the all-time record high and exceeded $2 000/oz for the first time in early August. This came off the back of the realisation that the global economy is being propped up by central bank and government stimulus given the lockdowns affecting businesses and households. With the oil price recovering to the US$35-40/bbl range, this provided tailwinds to the mining industry while demonstrating that certain industries were making tepid recovery as different countries opened up. As traders ceased their activities in the July to August period due to the northern summer, we saw many gold mining companies trade strongly and breaking records as the gold price rose.

We noticed that the gold mining stock prices began their decline on 21st September, and we expect that this will mark the start of the seasonally weak period that should carry through till late November if this year is anything like the previous years. Despite this, we have identified value potential in the large and mid-tier producers given that several of them have booked higher reserves and resources for the year net of depletion, either as a result of exploration successes or acquisitions of mine deposits or companies. Cash balances have been growing for many of these companies, buoyed by higher operating profit margins.

The fund's composition as at 30th September 2020 is given in the table below:

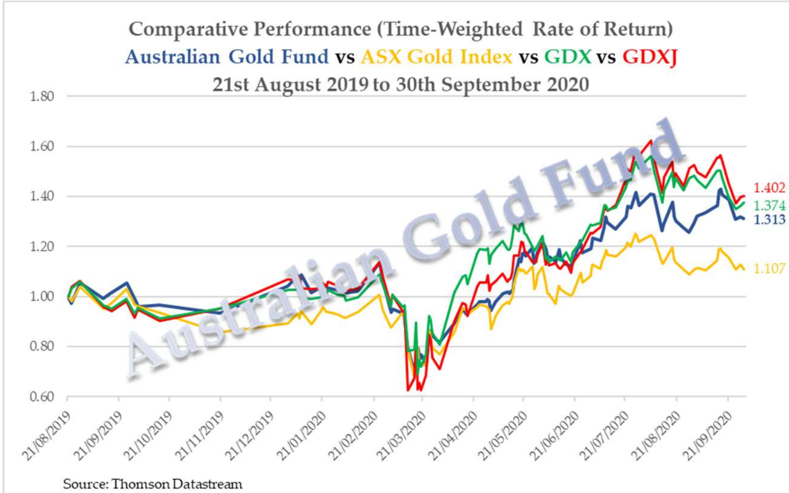
	% Portfolio by Market Value	Range
Cash	3.2%	2-10%
Major and Large Producers	16.4%	0-20%
Mid-Tier Producers	36.0%	0-60%
Junior and Micro Producers	25.0%	0-60%
Developers and Explorers	10.7%	0-10%
Precious Metals ETF	8.6%	0-30%

The Top 5 holdings are given in the table below:

Top 5 Holdings
West African Resources
Ramelius Resources
Resolute Mining
ETF Palladium
Westgold Resources

We took advantage of this strong quarter to rotate some of our stocks, especially towards smaller producers as well as developers including Calidus and Ora Banda that are at the phase of building infrastructure to extract minerals. Our Top 5 holdings saw minor changes with Ramelius Resources became our 2nd largest holding despite us reducing our holding by 15%, though offset by the Resolute Mining stock price decreasing more as a result of continued investor disappointment. We increased our Westgold Resources holding given our optimism over the company's prospects for 2021. Noteworthy performance during the quarter was in the developer companies including Cardinal Resources (a bidding war between Shandong Gold and Nordgold) and Kingsgate Consolidated (investors becoming more enthusiastic about a favourable settlement with the Thai government over the Chatree gold mine closure in 2016). Aeris Resources, Wiluna Mines, Kirkland Lake Gold and West African Resources also delivered strong performance during the quarter.

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:



Valuation Thesis

Our key valuation metric is the **EV/AISC-Adjusted Annual Production** as we have found in our empirical study that the market valuation is most aligned to this metric, as opposed to earnings, resources and reserves. We also prefer a multiples method over the typical Discounted Cashflow Method for valuation because we understand that beyond even one year of projection, everything is highly speculative – whether it is the management outlook on production and costs as well as the gold price and broader economic drivers. To allow for comparison across all classes of producers, our metric can standardise by the company's scope of production as we observe that the market values the companies with higher production with a greater multiple. However, we scale production by AISC because we believe that not all ounces are equal. Companies that can produce gold at lower cost are naturally more profitable and deserve a higher multiple of their production and other operational or financial performance measures. We use the following classes for the different tiers of gold producing companies – **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.).

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). This metric quantifies the market value of the company's assets deployed in the company's operations. The **AISC-Adjusted Annual Production** calculated as the annual production of gold per oz divided by the AISC adjusted by a factor of 1 000. The factor of 1 000 is arbitrarily chosen as a way to standardise the final metric. As an illustration, if a company produces 250 000oz p.a. at AISC of $1 250, the AISC-adjusted production is 200 000.

When determining the production ranges in our valuation metric, we take the management guidance as this is based on their access to information relating to their operations and progress. We believe that the market will use the guidance figures to base their valuation and investment decisions. This may not always be optimal given that some management may have their bias in reporting their outlook, as well as having a track record of announcing surprises. In such cases, we seek to qualify this in our SWOT analysis and adjust it in our EV/AISC-Adjusted Production multiple.

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.

We recognise that many analysts consider discretionary forecasts and adjustments on the company's production level, ore grade, cost levels, resources and reserves and economic factors into their valuation. We have studied many of these reports and recognise their merits. However, our view is that such subjective adjustments are dubious in terms of additional accuracy of their estimations. This is because with mining companies, both internal and external drivers that affect the company's future performance are unpredictable. Furthermore, we understand that while a company with substantial resources and reserves have potential to convert into substantial value in future, this is contingent on the successes in building the infrastructure, extracting the ore from the ground and processing it in a cost-effective manner. We recognise the criticism by many regarding our approach, but we have tried and tested our valuation against the actual price performance as well as through our own investment performance. We let these results speak for themselves.

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-$12 000/oz*

***Mid-Tier Companies** - $4 000-$7 000/oz*

***Micro and Junior Companies** - $1 500-$4 000/oz*

We also add that after reviewing our reports, we have found another metric that may inform the fair value ranges, namely the Operating Margin. The Operating Margin is the difference between the Gold Sale Price per oz and the AISC. A higher Operating Margin implies higher cashflow generation. We have also found that the market appears to take this into account when determining the price they will pay to purchase the stocks. We found that there is a link between the Operating Margin and our EV/AISC-Adjusted Production in that 8-12 times the Operating Margin gives a reasonable EV/AISC-Adjusted Production.

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