Australian Gold Fund

Performance Report

For Quarter and Year Ending 31st December 2021

Summary

2021 December Fund Performance Statistics					
	Australian Gold Fund	ASX Gold Index (XGD)	Van Eck GDX	Van Eck GDXJ
Quarter Performance	12.79%	12.57%	10.59%	11.40%
Quarter Volatility (%)	23.42%	24.59%	22.86%	27.13%
12 Month Performance	-1.88%	-9.34%	-9.52%	-21.25%
12 Month Volatility (%)	26.83%	28.75%	27.98%	34.32%
Performance Since Inception	24.31%	-12.17%	14.94%	9.86%
Volatility Since Inception (%)	35.81%	37.57%	43.80%	53.86%
Quarter % Days Outperform XGD	45.45%			
12 Month % Days Outperform	49.43%			
% Days Outperform Since Inception	51.84%			

The Australian Gold Fund finished the December 2021 quarter scraping ahead of its peer indices as the price of gold rallied strongly early in the quarter but was pushed down by the end of the year. Our fund delivered a 12.79% return for the quarter and the competitor indices all managed to finish the quarter at least 10% up. Interestingly, the fund could only exceed the ASX Gold Index on 45.5% of the trading days. However, our fund delivered stronger daily positive returns.

We finished the year delivering a loss of 1.88%. However, this occurred in a backdrop where the price of gold fell since the beginning of the year and gold stocks in general entered into correction territory on a few occasions. Peer indices suffered heavier losses, with all of them delivering losses. The ASX Gold Index came second and was down 9.34%, the Van Eck GDX Index fell by 9.52% while the Van Eck GDXJ fell by 21.25%.

Since inception, our fund is now ahead of all the peer indices by almost 10%. We achieved this with the lowest volatility of returns out of our peer indices. Therefore, our risk-adjusted returns are by far the highest. The Australian Gold Fund is ahead of the ASX Gold Index by over 36%, or almost 16% on an annualised basis since August 2019.

The fund's composition as at 31st December 2021 is given below:

	% Portfolio by Market Value	Range
Cash	0.9%	2-10%
Major and Large Producers	7.7%	0-20%
Mid-Tier Producers	36.2%	0-60%
Junior and Micro Producers	19.0%	0-60%
Developers and Explorers	34.1%	0-25%
Precious Metals ETF	2.1%	0-30%

Our Top 5 holdings are given below:

© Copyright 2022. Australian Gold Fund

Top 5 Holdings
Kingsgate Consolidated
West African Resources
Oceangold Corporation
Aeris Resources
Silver Lake Resources

The December 2022 quarter saw the price of gold try to break through the US$1,900/oz level after the heavy selloff in late September that brought gold down to US$1,730/oz. The month of October and the first half of November saw a very encouraging rally with gold rising almost 8% in US dollar terms and almost 7% in Australian dollar terms. Gold stocks rallied strongly off the back of this recovery as well. The ASX Gold Index increased by over 20% in six weeks, and was poised to bring gold stocks back to bull market territory.

However, this did not last. The US Federal Reserve again highlighted how inflation is running high and therefore there are plans to bring forward the rate hikes in 2022. This caused gold to tumble back below US$1,800/oz in the second half of November. The global markets also turned bearish with the announcement of the Omicron variant of the Wuhan virus in late November. At the time of writing this report, the Omicron variant is proving to be a highly virulent yet mild virus.

Gold and gold stocks had a rather tepid December and started showing signs it would head up at the closing days of the year. However, the looming rate hikes in 2022 are still keeping sentiment down as it appears that the first rate hike by the Federal Reserve will come earlier in the first half of 2022 than later.

During the December quarter, several gold stocks rallied strongly despite the see-sawing movements in the price of gold. The biggest rebounds come from the speculative gold explorers and junior producers. Notably, the strongest performers for the quarter that we held in our portfolio were Bardoc Gold (79.4%), Kingsrose Mining (79.2%), Pantoro (63.4%), Red 5 Limited (38.1%) and Aurelia Metals (36.7%). Several of the more established gold producers rose by 5-20% during the quarter.

Here at the Australian Gold Fund, we believe that there are signs suggesting that the first half of 2022 will see further back and forth movements in the price of gold. The central banks will likely move forward with raising interest rates that will keep the price of gold under pressure. The broader asset markets could begin buckling under the climate of constrained liquidity and hot money, which could lead to risk-off behaviour setting in by the second quarter of 2022. This may then set off the next rally in the price of gold into the second half of 2022 and a possible bull market in gold mining companies.

© Copyright 2022. Australian Gold Fund

Valuation Thesis (Updated 18th April 2021)

We analyse gold producing companies using the **Valuation to Profit Margin Multiple.** Our empirical studies have shown that the stock price is most aligned to this metric, as opposed to earnings, production, resources and reserves. Our metric is comparable across different classes of gold producers as it standardises by the company's scope of production. We observe that investors prefer companies with higher production and reward them with a higher multiple. The multiple combines the valuation metric, which we use the **EV/AISC-Adjusted Production,** and the **Profit Margin**.

The EV/AISC-Adjusted Production calculates the market value of one ounce of gold produced, adjusted by the All-In Sustaining Cost. The reason for scaling production by AISC is 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. The Profit Margin is the difference between the Realised Sale Price and the AISC.

As a rough guide, the fair value ranges for different mining company classes are as follows:

EV/AISC-Adjusted Production

***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*

Valuation to Profit Margin Multiple

***Major and Large Companies** – 8-12*

***Mid-Tier Companies** – 6-10*

***Micro and Junior Companies** – 3-5*

We believe a multiples method for valuation is more suitable than the typical Discounted Cashflow approach because the latter approach requires projection of cashflows into the future. We consider projection even beyond the next twelve months to be very speculative, especially in mining. We have observed the unreliable nature of management outlook on production and costs after seeing their track record. On top of that, forecasting the gold price and broader economic conditions that impact on the company's performance are also difficult.

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 calculates the market value of the company's

© Copyright 2022. Australian Gold Fund

https://www.goldfund.com.au

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.

We use the management guidance in our valuation input as this is the most objective information to base our estimates. We believe that investors similarly use this information in guiding their analysis and decision making. We recognise taking the management guidance at face value may not always be optimal as they tend to report favourable outlooks and may try to delay bad news. In such cases, we seek to qualify this in our SWOT analysis and adjust it in our Valuation to Profit Margin multiple.

The **Fair Valuation Range** in our reports reflects the price range we consider to be sensible based on the company's performance and the prevailing market conditions. We trade based on this range. We adopt the **margin of safety** approach (refer to Seth Klarman's book of the same title) and hence this range is wider than what typical equity research analysts would use in their reports. Companies trading outside the fair value range are significantly over or undervalued. Investors should look more deeply into the company's operations, financial performance and recent market announcements to determine if the market anticipates a possible re-rating. 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 may not necessarily improve the 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 a company have potential to convert their resources and reserves into cashflows in future. Their success is contingent on 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. We have tried and tested our valuation against the actual price estimates and our investment returns. We let these results speak for themselves.

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.

© Copyright 2022. Australian Gold Fund

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

Information in this report is not intended to be financial advice and should not be used as such. While every effort is made to ensure the information is reliable and accurate, errors and omissions may still exist. The interpretation of financial reports, market announcements and management commentary are subject to personal views and discretion. Users of this report are highly advised to seek professional financial advice before making their decisions.

© Copyright 2022. Australian Gold Fund