## Australian Gold Fund

# Performance Report

# For Quarter and Year Ending 30th June 2021

## Summary

| Fund Performance Statistics | | | | |
|---|---|---|---|---|
| | Australian Gold Fund | ASX Gold Index (XGD) | Van Eck GDX | Van Eck GDXJ |
| **Quarter Performance** | 14.21% | 6.60% | 4.56% | 3.86% |
| **Quarter Volatility (%)** | 30.14% | 31.94% | 33.55% | 28.31% |
| **12 Month Performance** | -0.51% | -18.48% | -6.88% | -4.22% |
| **12 Month Volatility (%)** | 31.86% | 33.03% | 42.65% | 35.56% |
| **Performance Since Inception** | 18.58% | -11.70% | 19.84% | 20.24% |
| **Volatility Since Inception (%)** | 38.42% | 40.23% | 58.63% | 47.68% |
| **Quarter % Days Outperform XGD** | 50.77% | | | |
| **12 Month % Days Outperform** | 54.79% | | | |
| **% Days Outperform Since Inception** | 52.67% | | | |

The Australian Gold Fund finished the June 2021 quarter significantly ahead of its peer indices. We delivered 14.21% return for the quarter, at least 7.5% more than the closest competitor, the ASX Gold Index. The fund exceeded the ASX Gold Index on 50.77% of the trading days. Also, the fund delivered its returns with a similar volatilty as its peers.

This is also the first full year for the Australian Gold Fund. We ended the financial year slightly down at 0.51%. However, Van Eck's GDXJ was the closest competitor and they were 4.22% down. Van Eck's GDX came next, losing 6.88% during the year. The ASX Gold Index was last, losing 18.48%. We beat the ASX Gold Index on 54.79% of the trading days. Our fund had the lowest volatility. Again, this shows we can deliver superior returns without taking extra risk.

Our fund is catching up to Van Eck's two gold funds during the year. We are less than 2% behind the two funds in terms of the returns since inception on 23rd August 2019. Our fund has also left the ASX Gold Index well behind, exceeding their cumulative returns by 30% and beating them on 52.67% of the trading days. We have the lowest volatility of returns out of the four gold funds.

The fund's composition as at 30th June 2021 is given below:

| | % Portfolio by Market Value | Range |
|---|---|---|
| Cash | 0.4% | 2-10% |
| Major and Large Producers | 13.6% | 0-20% |
| Mid-Tier Producers | 37.7% | 0-60% |
| Junior and Micro Producers | 28.2% | 0-60% |
| Developers and Explorers | 20.0% | 0-25% |
| Precious Metals ETF | 0.0% | 0-30% |

Our Top 5 holdings are given below:

| Top 5 Holdings |
|---|
| *West African Resources* |
| *Aeris Resources* |
| *Silver Standard Resources* |
| *Ramelius Resources* |
| *Silver Lake Resources* |

The June 2021 quarter saw much volatility especially at the end of the June with a massive industry-wide selloff in the last three weeks. The quarter started with a gradual recovery in the price of gold that led to gold and silver stocks rallying. By the end of May, the ASX Gold Index was 22.5% higher than at the start of the quarter. Our Australian Gold Fund rallied 24.8% by that time.

The US Federal Reserve Open Market Committee indicated in mid-June after their meeting that they were concerned about inflation in the economy. James Bullard talked about the possibility that the Federal Reserve would act more proactively to control inflation by raising the Federal Funds Rate.

While the FOMC discussed that they expect to increase the Federal Funds Rate in 2023, this is supposed to sound more dovish than the financial news portrayed it. After all, 2023 is two years away.

Nonetheless, investors took this cue to sell down gold. The price of gold fell almost US$100/oz in the matter of a week. Gold stocks fell over 10% in the month of June, one of the most severe in recent times.

The top performers in our portfolio during the quarter were Aeris Resources (up 95%) and Alkane Resources (up 67%). Most of the companies in our portfolio traded higher at the end of the quarter.

Dacian Gold was the worst performer, down 22.6%, after raising capital to fund their expansion plans. Regis Resources performed poorly during the quarter (down 19%), after raising capital to fund their purchase of the 30% stake in the Tropicana Mine.

During the quarter, our major transactions included increasing our holdings in Kirkland Lake Gold, Regis Resources, Silver Lake Resources, St Barbara Mines and West African Resources. We added to our portfolio Bardoc Gold, Bellevue Gold, Investigator Resources, Kalamazoo Resources, Kairos Minerals and Musgrave Minerals. We reduced our holdings in Aeris Resources, Kingsgate Consolidated, Oceanagold Corporation, Ramelius Resources and Westgold Resources.

We have shifted our portfolio to increase our exposure more towards the speculative end to include more explorers and mine developers in anticipation of a much higher price of gold and silver in the future. We also expect these companies to make significant discoveries and achieve milestones that could lead to a re-rating in their prices.

## 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 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.

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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