Australian Gold Fund

Performance Report

For Quarter and Year Ending 30th September 2021

Summary

Fund Performance Statistics				
	Australian Gold Fund	ASX Gold Index (XGD)	Van Eck GDX	Van Eck GDXJ
Quarter Performance	-7.05%	-11.64%	-13.27%	-17.99%
Quarter Volatility (%)	24.52%	26.06%	25.67%	32.21%
12 Month Performance	-15.73%	-29.50%	-24.35%	-29.64%
12 Month Volatility (%)	29.26%	31.46%	31.65%	38.68%
Performance Since Inception	10.22%	-21.97%	3.93%	-1.38%
Volatility Since Inception (%)	37.02%	38.83%	45.69%	56.23%
Quarter % Days Outperform XGD	50.00%			
12 Month % Days Outperform	52.87%			
% Days Outperform Since Inception	52.68%			

The Australian Gold Fund finished the September 2021 quarter significantly ahead of its peer indices, despite a difficult quarter where gold stocks kept falling. Our fund delivered a -7.05% return for the quarter, at least 4% better than our closest competitor, the ASX Gold Index. The fund exceeded the ASX Gold Index on 50% of the trading days. Again, we managed to deliver our results with the lowest volatility compared to our peers.

The last 12 months have been challenging as gold stocks began correcting in September 2020 after hitting a peak. Our fund's returns is markedly above our peers despite posting a -15.73% decline. We were ahead of our peer indices by at least 8.5% and beat the ASX Gold Index on 52.87% of the trading days.

Since inception, our fund is now ahead of all the peer indices by at least 6%. We managed to overtake our competitors over this quarter as the gold stocks in general faced a strong sell-off thanks to talks that the Federal Reserve will taper. The Van Eck GDX and GDXJ indices fells back substantially over this quarter, allowing us to take the lead. We are now up 10.22% since the fund's inception in August 2019, outperforming the ASX Gold Index by more than 30%.

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

	% Portfolio by Market Value	Range
Cash	23.5%	2-10%
Major and Large Producers	5.2%	0-20%
Mid-Tier Producers	23.2%	0-60%
Junior and Micro Producers	23.6%	0-60%
Developers and Explorers	24.4%	0-25%
Precious Metals ETF	0.0%	0-30%

Our Top 5 holdings are given below:

Top 5 Holdings
Aeris Resources
West African Resources
Oceangold Corporation
Kingsgate Consolidated
Westgold Resources

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The September 2021 quarter saw gold and gold mining companies face a series of false start rallies before grinding down resulting from the prevailing narrative that the US Federal Reserve would reduce the buyback of mortgage-backed securities to stimulate the economy. However, against this backdrop of potential tapering of the currency printing program are two major tailwinds for gold and gold mining companies.

The first is that the Federal Reserve recognises that inflation would linger for the rest of the year, longer than they initially expected.

The second is the partial default by Evergrande Group, one of the world's largest property developers, of their interest payments to foreign investors. This Chinese property developer has over US$300 billion of debt. Its partial default on its interest liabilities shows the group's liquidity problems are urgent. By choosing to honour only the local creditors, it also highlights the extent to which the Chinese property market is under grave danger.

The financial markets retreated heavily in the last two weeks of the September quarter. Gold stocks fell further, despite financial events such as a looming market crisis should allow gold to rally.

Given the grinding down of gold stocks and an expectation for a broader market crash to occur soon, we decided to reduce some of our gold stock holdings and hold over 20% cash. This is the largest cash allocation the fund has ever held since its inception. Our fund did not sell out of any gold companies, only reducing our exposure to them.

Over 80% of the companies we held in our portfolio fell during the quarter. The companies that increased over the quarter were predominantly small-cap gold mining companies with the exception of Kirkland Lake Gold and Red 5 Limited. The top performers in our portfolio during the quarter were Kingsgate Consolidated (up 88%), Duketon Mining (up 18%) and Calidus Resources (up 15%). The worst performers were White Rock Minerals (down 45%), Aurelia Metals (down 27%) and Alkane Resources (down 26%).

During the quarter, we reduced holdings to most of the large and mid-tier producers. We added to our portfolio several speculative explorers and developers including Black Cat Syndicate, Duketon Mining, Rox Resources, Tulla Resources.

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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

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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.

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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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