Australian Gold Fund

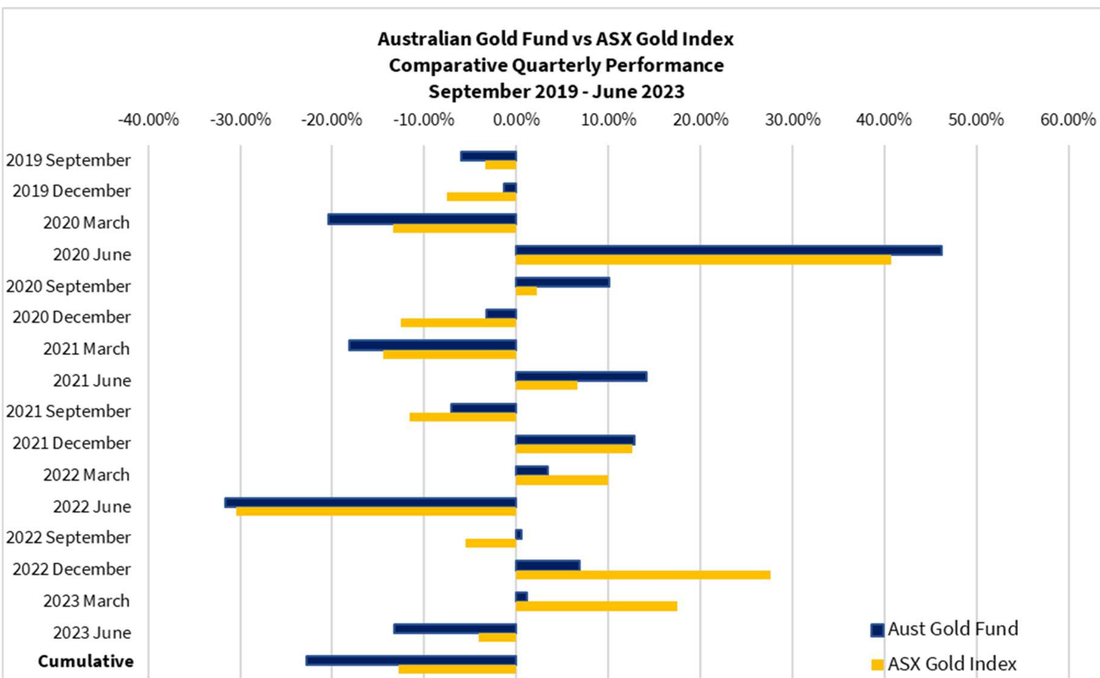
Performance Report
For Quarter and Year Ending 30th June 2023

Summary

2023 June Fund Performance Statistics				
	Australian Gold Fund	ASX Gold Index (XGD)	Van Eck GDX	Van Eck GDXJ
Quarter Performance	-13.24%	-4.12%	-6.92%	-9.73%
Quarter Volatility (%)	22.97%	25.70%	26.34%	28.67%
12 Month Performance	-5.62%	35.78%	11.86%	12.02%
12 Month Volatility (%)	25.78%	33.37%	36.59%	42.08%
Performance Since Inception	-17.01%	-8.69%	9.91%	-6.07%
Volatility Since Inception (%)	32.96%	36.36%	41.15%	49.62%
Quarter % Days Outperform XGD	44.62%			
12 Month % Days Outperform	42.53%			
% Days Outperform Since Inception	48.84%			

The Australian Gold Fund finished negative again for the 2023 June quarter and the 2022-23 financial year. It underperformed against other gold stock indices over these periods.

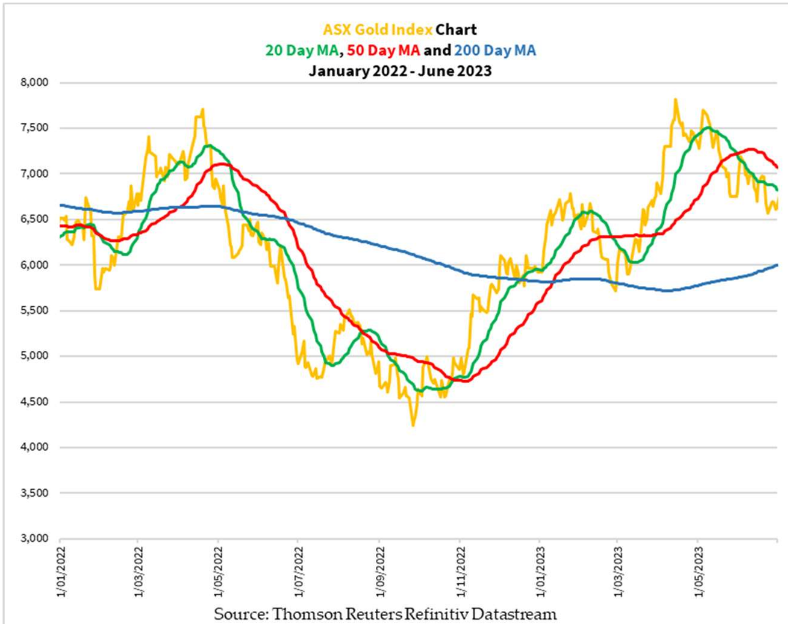
The historical quarterly performance for the Australian Gold Fund is given below:



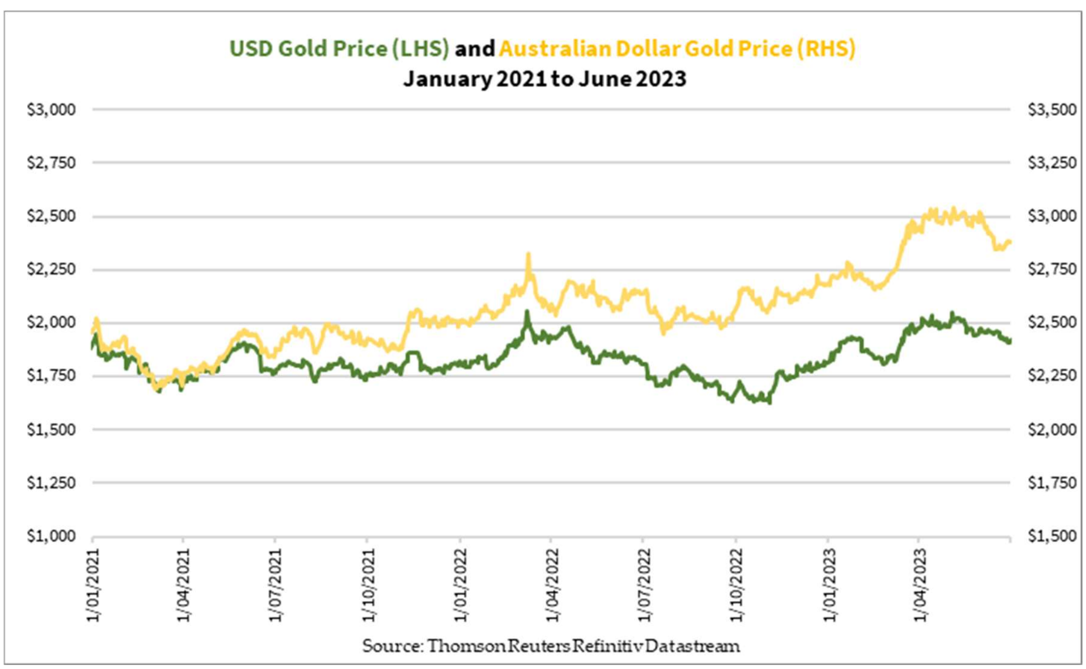
Source: Australian Gold Fund

The brutal bear market that occurred from April to late-September 2022 heavily impacted the entire gold stocks space. While producers staged a recovery from late-September 2022 and again in March-April 2023, gold explorers and early-stage developers continued to lag. As this occurred, the Australian Gold Fund portfolio increased its exposure to these companies thereby contributing to the underperformance against the indices which weighted more to producers and late-stage developers.

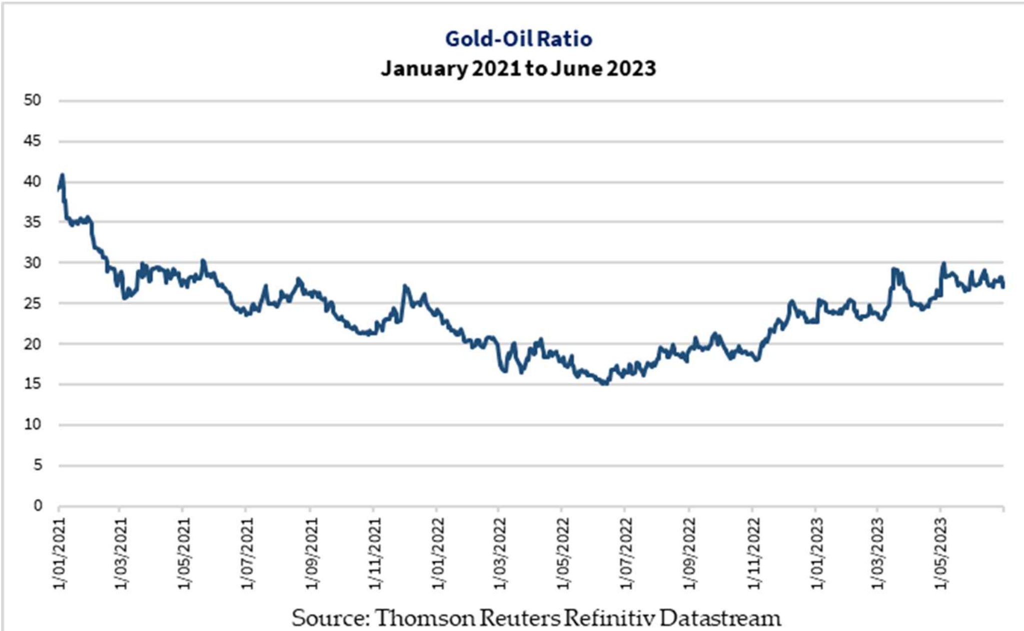
The past quarter started strongly as gold again broke past the US$2,000 an ounce barrier. In Australia, it made record highs of $3,080 an ounce. This caused gold stocks to enter the second phase of a bull run after the February correction. It lasted till mid-April when the ASX Gold Index rose to levels last seen in April 2022. The subequent correction lasted to the end of the quarter causing the ASX Gold Index to end the quarter at around 6,600 points as you can see in the figure below:



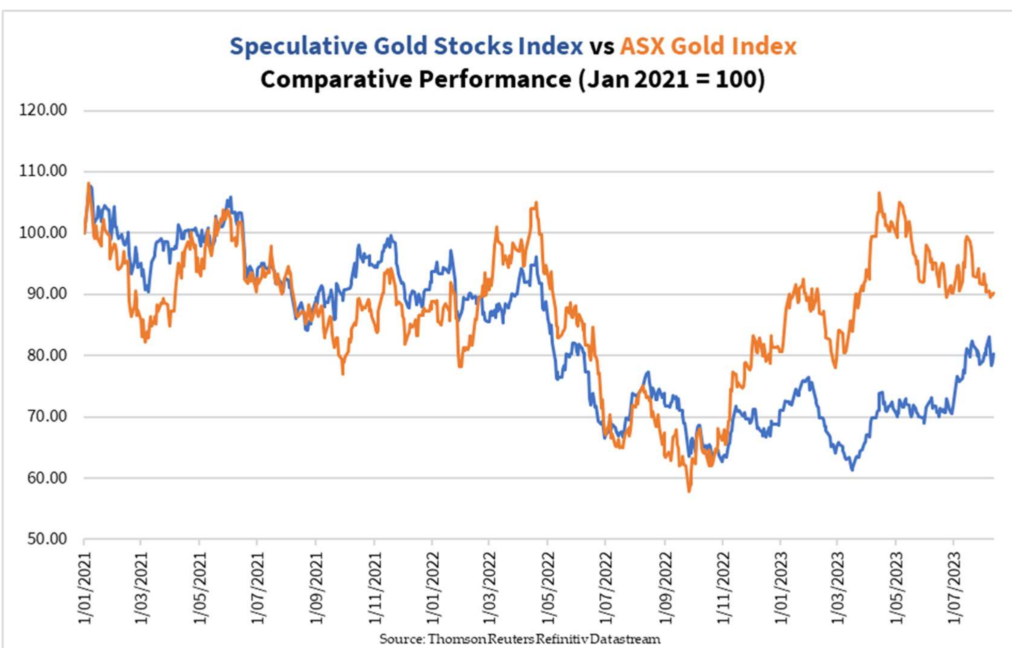
Gold and gold stocks corrected when the long-term real yield began rising again in the US. The falling headline CPI figures gained pace as the impact of the slowing in the pace of the US Federal Reserve rate rises took effect. On average it takes six to nine months for this to happen. Even though core inflation remained stubbornly high, gold retreated back below US$2,000 and traded in the US$1,800-1,970 range for the rest of the quarter:



Gold producers benefit from a higher gold-oil ratio and this could contribute to improved profitability in the next quarter. The price of oil was favourable during the quarter as it traded between US$65-75 a barrel, causing the gold-oil ratio to rise above 25. The average gold-oil ratio was 24.9 for the 2023 March quarter while this quarter's average increased to 26.9.



While gold producers retreated in the correction, gold explorers as a group held their ground well after reaching a bottom in mid-March, albeit trading at depressed levels compared to the more established gold producers. The gap between the two groups is starting to close even though individual gold explorers continued to make new lows as some needed to raise capital, sometimes at deep discounts.



Our strategy aims to catch up and outperform the gold indices as we had in past gold bull markets by increasing our exposure to companies with a better return to risk profile. At this stage of the gold bull market, producers have recovered significantly from their lows last year. Their upside potential remains favourable with mid-tier producers looking more appealing. However, the speculative gold stocks have pulled back and in some cases even made new lows in recent months. When the bull market comes to these stocks, we expect the recovery to be phenomenal. As it occurs once every few years, our view is to wait patiently to reap these rewards.

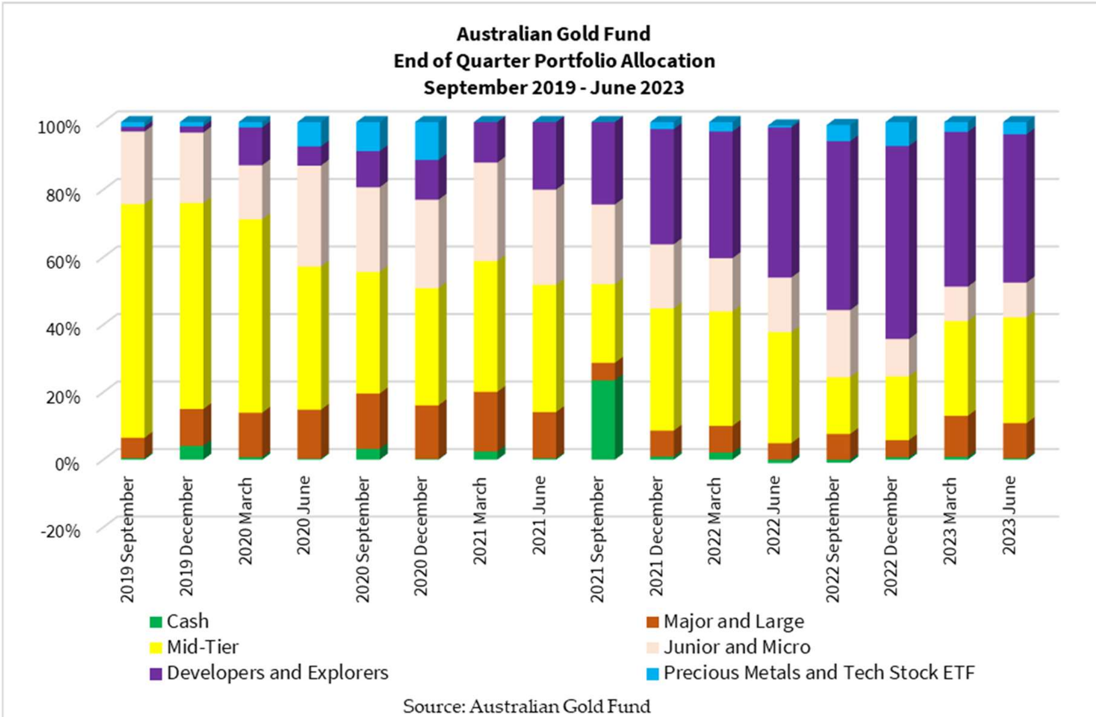
The fund's composition as at 30th June 2023 is given below:

	% Portfolio by Market Value	Range
Cash	0.4%	2-10%
Major and Large Producers	10.4%	0-20%
Mid-Tier Producers	31.4%	0-60%
Junior and Micro Producers	10.3%	0-60%
Developers and Explorers	43.9%	0-25%
Precious Metals and Tech ETF	3.6%	0-30%

The Australian Gold Fund did not change its fund composition much during the quarter although it made several trades to take some profits on gold producers while adding a modest amount into the explorers and developers. However, the composition does not reflect this as our developer and explorer positions fell further in price into the quarter.

Our exposure to the Short Nasdaq Index ETF reduced not because of us reducing our holdings but the Nasdaq Index staged a stunning recovery during the quarter on the back of the AI boom.

Our historical allocation is in the figure below:



Our Top 5 holdings are given below:

Top 5 Holdings
Kingsgate Consolidated
Oceanagold Corporation
Delta Lithium
Musgrave Minerals
Black Cat Syndicate

During the quarter, our Top 5 Holdings saw two of our previous top holdings, Aeris Resources and Westgold Resources be replaced by Delta Lithium and Musgrave Minerals.

Aeris Resources fell from our Top 5 holdings as it retreated from copper failing to rally in the recent months. We reduced our Westgold Resources holdings to take some profits due to its solid recovery as the company announced that it would be an unhedged producer in July.

Delta Lithium rose to become our third largest holding as the company rallied strongly off the back of good news that it could begin producing lithium spodumene as early as late-2023. We sold some of our holdings during the quarter as it rallied, allowing us to realise some profits.

Musgrave Minerals received a bid from Westgold Resources in early June causing its share price to rise around 60% during the quarter. However, Ramelius Resources swooped in early July and beat Westgold Resources to become its new owner, effective in the end of August.

Our holdings in Black Cat Syndicate continue to be a significant one for our portfolio. We did not buy or sell any during the quarter even though its price continued to fall. The company released updated mine plans for all three gold projects it owned in July, with plans for a restart at Paulsens to go ahead later this year.

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.

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