Australian Gold Fund

Performance Report
For Quarter and Year Ending 31st March 2023

Summary

2023 March Fund Performance Statistics					
	Australian Gold Fund	ASX Gold Index (XGD)	Van Eck GDX	Van Eck GDXJ
Quarter Performance	0.90%	17.43%	12.87%	10.80%
Quarter Volatility (%)	23.12%	31.97%	33.35%	36.89%
12 Month Performance	-25.60%	-1.42%	-14.20%	-15.28%
12 Month Volatility (%)	28.60%	35.83%	39.02%	45.56%
Performance Since Inception	-4.35%	-4.76%	18.08%	4.05%
Volatility Since Inception (%)	33.55%	36.99%	41.99%	50.76%
Quarter % Days Outperform XGD	33.85%			
12 Month % Days Outperform	44.44%			
% Days Outperform Since Inception	49.52%			

The Australian Gold Fund finished the 2023 March quarter underperforming against its peers once again. The shift in the portfolio strategy to overweight on speculative gold stocks such as late-stage explorers and developers over producers has resulted in the portfolio falling behind in the rolling 12-month period returns. Since inception, the Australian Gold Fund is down just under 5% and is only slightly outperforming the ASX Gold Index over the same period. During the quarter, the fund only outperformed the ASX Gold Index on 33.85% of the trading days, similar to the last quarter.

During the first three months of 2023, gold mining companies continued on its bull run. However, the entire February saw the industry experience a significant correction with the gold stock indices falling almost every day of the week. This correction was partly driven by the change in the methodology in calculating the US Consumer Price Index that saw the headline inflation for January 2023 retreating more than expected, causing the long-term real yield to rise. The other reason appearaed to be due to the rhetoric from the US Federal Reserve suggesting that there could be more rate rises still to come. All these placed pressure on the price of gold. This changed in late-March when the markets began to look beyond the rate rises and were foreseeing the interest rate to fall by the end of the year. The price of gold rose above US$2,000 an ounce for a few hours before retreating below that psychological barrier as the quarter ended.

Now that the central banks are largely done with their rate rises, the coming quarters should continue to be bullish for gold as inflation remains stubbornly at elevated levels. Even with hedonic adjustments and changes to calculation methodology, there is no denying that the last three years of monetary and fiscal policy blunders have created lasting damage on the global economy. Business confidence continues to remain weak and the global supply chain will need many years to restore to pre-2020 levels.

The process of dedollarisation is continuing with more Middle East, Central America, South America and African nations likely to move away from the US dollar to their own currencies for oil and trading. This should see inflation and the gradual reversal of the rate rises by central banks to boost gold in the medium term. As countries move away from the US dollar for petrol sales, the shift by the US to try to bring back manufacturing onshore and also the global order moving to a multipolar world order rather than a US petrodollar order, this should benefit gold and other commodities in the long term.

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The fund's composition as at 31st March 2023 is given below:

	% Portfolio by Market Value	Range
Cash	0.8%	2-10%
Major and Large Producers	12.2%	0-20%
Mid-Tier Producers	28.0%	0-60%
Junior and Micro Producers	10.2%	0-60%
Developers and Explorers	45.9%	0-25%
Precious Metals and Tech ETF	2.9%	0-30%

The Australian Gold Fund's position continues to be overweight on the speculative end of gold stocks, being developers and explorers. The portfolio weights at the end of this quarter have moved back towards producers as a result of Calidus Resources, Tietto Minerals and Tulla Resources commencing production.

We recognise that our heavy bias towards developers and producers has led to significant underperformance against the peer indices. Since late-September 2022, producers have found their lows and staged a significant recovery. However, explorers and developers have largely languished and some companies even made new lows in February and March 2023. During the quarter, we have continued to double down on buying some explorers and developers that persisted in falling. We even sold down some of our producers that have rallied significantly in order to do this. This strategy has yet to pay off but we are confident that the rewards will come as the gold bull market picks up momentum and buying interest comes into the speculative end of this industry. History has shown that this can happen, with astounding rewards.

Our Top 5 holdings are given below:

Top 5 Holdings
Kingsgate Consolidated
Oceanagold Corporation
Westgold Resources
Black Cat Syndicate
Aeris Resources

There have been some changes to this list compared to last quarter as the price of some of our biggest holdings fell during the quarter, namely the ETF Short NASDAQ Index, Red Dirt Metals (now renamed to Delta Lithium) and West African Resources. We increased our exposure to Westgold Resources and Aeris Resources during this period. The former due to our conviction that the heavy capital spending is behind it and that the company's gold sales will soon be completely unhedged. As for Aeris Resources, we take a long-term view on its growth given its expanded portfolio after acquiring Round Oak Minerals last April.

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

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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

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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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