Australian Gold Fund Valuation and SWOT Analysis

Aurelia Metals Limited (ASX: AMI)

Date	17/06/2019
Classification	Mid-Tier Gold Miner
Current Price	$0.475
No. Issued Stocks (m)	867.9
Net Cash + Bullion + 0.5 x GIC ($ m)	$108.60
Last Dividend Payment ($ p.a.)	$0.00
Market Capitalisation ($ m)	$412.24
Enterprise Value ($ m)	$303.64
Resources (oz)	770,935
Reserves (oz)	364,138

Ranking	Undervalued
Price Range	$0.427-$0.70
Annual Gold Production Guidance (oz p.a.)	110 000-120 000
All-In Sustaining Cost Guidance ($/oz)*	$950-$1 050
EV/AISC-Adjusted Production Guidance ($/oz)	$2,640.00
EV/AISC-Adjusted Production Range ($/oz)	$2 500-$4 000
EV/Resources ($/oz)	$393.86
EV/Reserves ($/oz)	$833.86

* Includes by-product credits from Ag, Cu, Pb and Zn

Summary

Aurelia Metals is a mid-tier multi-metal mining company producing gold, silver, copper, lead and zinc in the Cobar region of NSW. The company commenced production in their Hera operations in 2015 and since April 2018, the Peak operations after acquiring it from Glencore for A$59m. The company's stock price dropped around 50% from its peak in late March 2019 of $0.99 to as low as $0.465 after a disappointing March quarterly report as well as the sudden departure of the CEO Jim Simpson shortly thereafter. Further hesitation from investors came about in early June with an announcement stating that the Nymagee prefeasibility study in the Hera operations being deferred despite its progress being 95% and also the increase in the required capital expenditure spend in the Peak operations for a lead-zinc processing circuit from $35m to $53m.

The March quarterly results were disappointing with total gold production at 23 323oz at $1 302/oz, down from 35 834oz at $732/oz. The most significant driver to the poor performance was from the Peak operations where production was down to 9 132oz at $1 600/oz, compared to 19 610oz at $917/oz. Management attributed this decline in performance as a result of lower ore mined (20% lower), milling volume (reduced by almost 30%) and a 33% decline in ore grade processed. All these contributed to an underwhelming result in the mine that had been operating under the company's control for just under one year. The Chronos ore grade is expected to reduce substantially by almost 45% and will continue to contribute to lower production. The Hera operations also delivered marginally weaker performance compared to the last quarter, but not to the extent of the Peak operations.

Despite the underperformance for the March quarter, the company saw their cash and bullion balance increase by just under $1m to $108.6m with no debt. The company had managed to deliver within 5 months full payback of the price paid for acquiring the Peak mine operations and repaid their debt with Glencore in full as at the end of the 2018 financial year. However, the phenomenal performance has been partly a result of high grading at the Peak operations where ore mined and milled in the first quarter of performance in the last quarter of 2018 were 9.61g/t and 8.83g/t, respectively. The most recent ore mined and milled grades were 3.08g/t and 3.34g/t, respectively. The grades mined and milled now are more consistent with the 2018 Reserves figures, which may temper the company's strong performance thus far. Based on the 12th June announcement, the Peak operations are seeing a gradual return to the level seen in the December quarter.

Going forward, the company's Hera operations are expected to decline in ore volume and grade. While no fixed estimates are available, assuming that the ore mined and ore grade are around the levels of the most recent quarter, this implies around 460kt of ore at 4g/t, yielding around 59 000oz p.a. of gold at AISC of around $950-$1 000/oz. As for the Peak operations, the ore volume is expected to increase to 580-630kt but ore grade will revert to around the ore grade of reserves as at 2018, which is 3.48g/t. This equates to gold production of around 64 800-70 400oz p.a. Excluding the expansion cost of the lead-zinc processing circuit, AISC would be $950-$1 000/oz. Thus, the company's expected gold production

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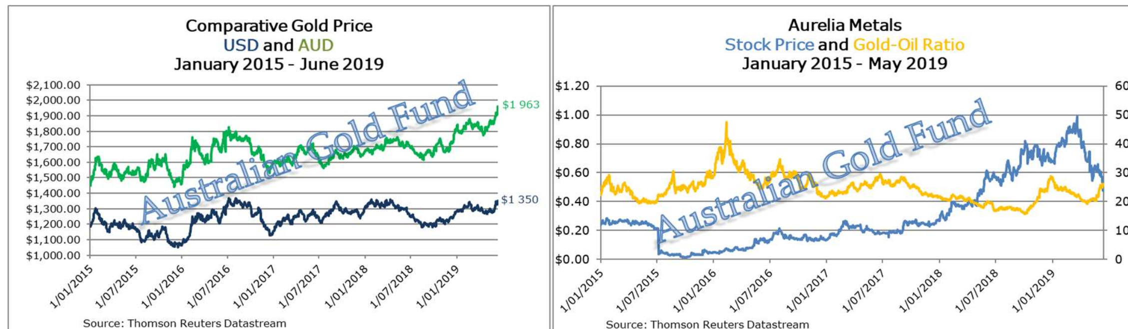
next year could be in the range of 120 000-135 000oz (assuming some variation in both mines) at AISC of around $950-$1 000/oz. On top of this the company expects to spend $20m on exploration and $53m on the lead-zinc circuit. The company may still be able to generate around $10-$20m of free cashflows after including all other expenses.

Based on the 2019 guidance, the current stock price of $0.475 implies undervaluation. Notwithstanding the confirmation of the Resources and Reserves, the 2020 guidance and the June 2019 quarterly results, the company has a sustainable level of production, strong cash balance and a clear program to replenish its existing reserves as well as expanding this. However, uncertainty still exists given investors are much less forgiving for disappointing performance in this season.



Prevailing Environment

The March quarter has been a challenging one for many gold mining companies despite the gold price trading in the US$1 280-1 345/oz and A$1 790-1 880/oz range. Part of this is caused by the oil price rising 33% from US$45/bbl to US$60/bbl during the quarter, leading to the gold to oil ratio placing some pressure on costs. Since the December 2018 rate rise by the US Federal Reserve that brings the Federal Funds Rate to 2.25-2.5%, the gold price rose to over US$1 300/oz and reached as high as US$1 345/oz in late February. The corresponding rise in the oil price came as a result of higher demand during the northern hemisphere winter as well as increasing geopolitical tension in the Middle East. Furthermore, the oil price rose partly due to reduction in the US inventory. The gold to oil ratio for the March quarter started at a strong 28.3 and gradually fell to 21.5 at the end of the quarter, resulting in an average gold to oil ratio of 23.9 during this period.

Since the end of the March quarter, the gold price weakened to below US$1 300/oz while oil held above US$60/bbl until late May when the US Federal Reserve had a change in tone regarding interest rate rises going forward. Some central banks have indicated rate cuts may occur in the future. Furthermore, the oil price weakened sharply as the US Department of Energy revealed that their crude oil inventory has increased. By mid-June, the gold price has risen to the US$1 330-$1 350/oz range, while breaking the all-time records for the Australian dollar. With oil price in the low 50's, this is an excellent backdrop for gold and other resources companies to operate. As foreshadowed in reports last month, the June to July period usually is one where fortunes turn for mining companies. 2019 appears to be no exception.

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Operational and Financial Performance Charts

SWOT Analysis

Strengths	Weaknesses
• Large cash balance generated through operational success in the last 15 months. • Multi-metals mining provide by-product credits on production and may offset costs. • Management has significant exploration and expansion plans that are backed by sufficient cash balance to make it happen.	• Low reserves and resources implying short mining life of approximately 4 years, notwithstanding replenishment. • The mines are ageing with declining grades apparent in the last three quarters. The most recent quarter of production has alarmed investors given the grades decline.
Opportunities	**Threats**
• Extensive opportunities exist in the Nymagee, Chronos and Kairos deposits, with potential booking of new reserves and resources much needed for the company. • The Peak lead-zinc processing circuit will improve production of base metal by-products. • Balance sheet has capacity for acquisitions (Glencore's CSA project?)	• The ageing operations may see sharper declines in ore volume and grade, leading to further rising costs that may run down their current cash balance. • Contractor bottlenecks may further increase delays in their operations and expansion plans.

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Peer Comparison

Glossary

The gold mining companies are classified based on their production level on an annual basis. The classification used in this report is as follows – **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 **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 **EV/AISC-Adjusted Annual Production** is a *comparative measure* used for valuing companies in this report and can be used to determine relative value. The enterprise value is

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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). The AISC-adjusted annual production is measure whereby the annual production of gold per oz is divided by the AISC adjusted by a factor of 1 000. The intuition behind this measure is to value the company by taking into account annual production but giving favourable treatment for lower AISC and penalising for higher AISC. The factor of 1 000 is arbitrarily chosen. As an illustration, if a company produces 250 000oz p.a. at AISC of $1 250, the AISC-adjusted production is 200 000.

The metric is used to determine the Price Range for the company. This range takes into account the baseline range depending on the company's classification, as determined by the annual gold production level. The range can be adjusted upwards or downwards based on other factors that are presented in the SWOT Analysis section.

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

Major and Large Companies - $6 000-8 000/oz

Mid-Tier Companies - $2 500-5 000/oz

Micro and Junior Companies - $800-1 800/oz

The metric is by no means perfect and other factors should be considered including reserve and resource life, projected production volume and costs, management quality and geographic location. Further, it is of a retrospective nature, focusing on past performance and this may not be a good indicator for future performance.

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.

The **Price Range** determines a reasonable range for which the company stock price should be trading at. This range is relatively wide as it considers the *margin of safety*. A company whose stock price is currently outside the fair value range is significantly over or undervalued and investors should look more deeply into the company's operations, financial performance and

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recent market announcements. 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.

Disclaimer

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