Australian Gold Fund Valuation and SWOT Analysis

Stock Valuation Report
Aurelia Metals Limited (ASX: AMI)

Date	4/11/2019
Classification	Mid-Tier Gold Miner
Current Price	$0.510
No. Issued Stocks (m)	867.9
Net Cash + Bullion + 0.5 x GIC ($ m)	$93.10
Last Dividend Payment ($ p.a.)	$0.02
Market Capitalisation ($ m)	$442.62
Enterprise Value ($ m)	$349.52
Resources (oz)	804,566
Reserves (oz)	330,073

Ranking	**Fair Value**
Price Range	$0.34-$0.63
Annual Gold Production Guidance (oz p.a.)	85 000-95 000
All-In Sustaining Cost Guidance ($/oz)*	$1 050-$1 250
EV/AISC-Adjusted Production Guidance ($/oz)	$4,466.00
EV/AISC-Adjusted Production Range ($/oz)	$3 000-$4 500
EV/Resources ($/oz)	$434.42
EV/Reserves ($/oz)	$1,058.92

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

Summary

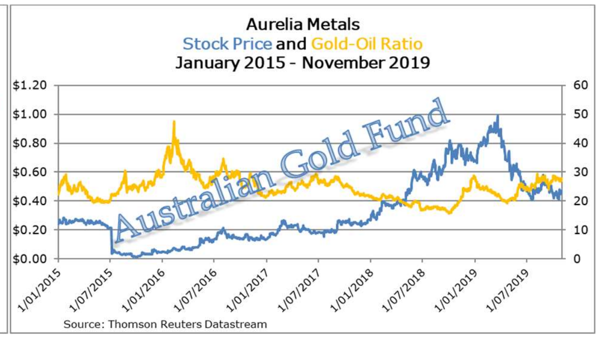
Aurelia Minerals Limited appears to be turning around after over half a year of limbo with the departure of the CEO Jim Simpson and also their announcement in April that their production and ore grade are on a decline. A new CEO and COO, Dan Clifford and Peter Trout, have been appointed and will commence their positions in late November. Despite the downturn for the company, management declared a 2c dividend for 2019 and their cash balance stands at $93.1m with no debt. Going forward, the company has substantial plans for exploration on their existing properties at the Hera and Peak Mines.

The company delivered 117 520oz of gold at AISC of $1 007/oz net of by-product credits for the 2019 financial year. This result was overshadowed by increasing costs at the Peak Gold mine in the March and June quarters when gold production was in the 9 000-10 000oz range with the AISC exceeding A$1 600/oz. The September quarter saw the company deliver 29 307oz at AISC of $988/oz, with the Peak mine delivering 18 772oz at AISC of $764/oz and the Hera mine delivering 10 535oz at AISC of $1 149/oz. The Peak mine processed higher grade ore in their plants during this quarter, returning to the levels seen over much of last year, but the mined ore grade for the quarter was less than 3g/t.

Results for the September quarter appear to suggest that Aurelia Minerals is far from having reached its peak. The company is expecting to have a weak December quarter as a result of a planned upgrade in the Peak mine processing plant to increase production of the lead and zinc ore feed from the Chronos deposit. This planned upgrade is expected to cost $40m, with $38m to be spent for this financial year. While the company's release of the 2020 production outlook points to lower production for both the Peak and Hera mines – at 85 000-95 000oz at AISC of $1 050-$1 250/oz with Hera expected to produce 33 000-36 000oz and Peak producing 52 000-59 000oz, an update on the company's exploration dated 31st October showed exceptional intercepts in the Kairos and Federation deposits. Furthermore, the company is embarking on an aggressive exploration campaign to unlock further value going forward. Results thus far are encouraging, but the company is indeed needing to win back the trust of its disappointed investors.

The company's balance sheet is robust, with the cash balance as at 30th September standing at $93.1m, after $17.4m being paid as dividends and capital expenditure spending of $28m. During the quarter, they sold 30 747oz of gold at $2 132/oz, although they paid $9m from their gold hedging position at an average price of $1 736/oz. The company still has 35 000oz to be delivered over the next three quarters at an average price of $1 854/oz. While these hedges were strategically taken at the time, the gold price has moved up substantially since, thus they are currently out-of-the-money.

In evaluating this company's investment potential, several factors need to be taken into account. The company has indeed disappointed investors over the last seven months and management was not particularly forthcoming in providing updates or warnings about their performance. The September quarter results and outlook are encouraging for the longer term, but we are seeking confirmation on milestones such as the processing plant at Peak delivering to nameplate capacity, conversion of resources and reserves from exploration campaigns and also improvement in operational performance in the second half of the year with more sustained production and lower AISC. We are cautious to assign a fair valuation range of EV/AISC-Adjusted Production of $3 000-$4 500/oz as a result of a higher gold price but offset by the company's uncertainty and volatile performance. Given this, the current stock price of $0.51 implies the company is currently fairly valued.

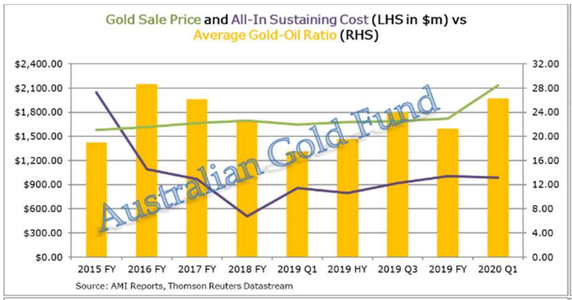


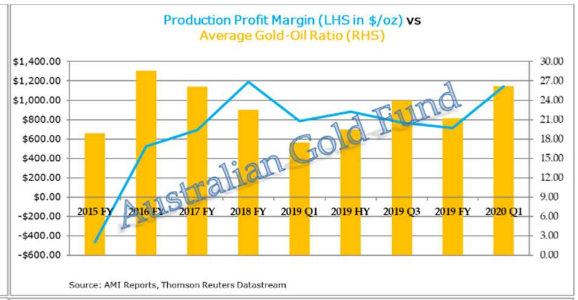
Prevailing Environment

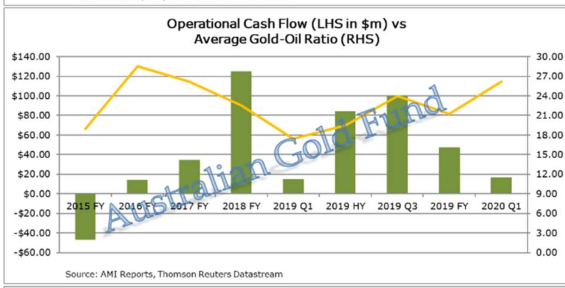
The gold price has remained above US$1 400/oz or A$2 000/oz since end of May 2019 when the central banks around the world abandoned their strategy to normalise their monetary policy but resumed reducing rates in light of further signs of economic weakness. The chronic effects of the financial system being dependent (even addicted) to liquidity and stimulus have definitely shown itself to be all but reversible. Developed nations are seeing their economies register low to zero and even negative GDP growth, with recession becoming increasingly a reality in the future. While certain government and economic experts inform via mainstream media that such conditions are a result of the US-China trade wars, this seems to fly in the face of the stock market movements becoming increasingly disconnected with developments in negotiations. At the same time, the US Federal Reserve has cut the Federal Funds Rate three times since end of July from 2.25-2.5% to 1.5-1.75%. Thus, the Federal Reserve has cut rates in each of the three meetings they have held and it is expected that they will continue to cut rates in the future. Furthermore, the US Federal Reserve has announced further currency creation to purchase non-performing loans but deny calling it "quantitative easing" even though everything about what they are doing points to it.

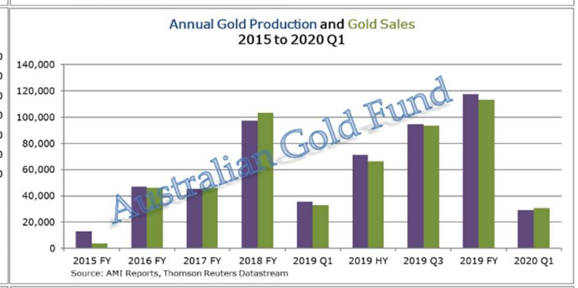
In Australia, the Reserve Bank has cut interest rates three times since June 2019 with the latest cut in October bringing the 24-Hour Cash Rate to 0.75%. The Australian economy has continued to show signs of weakness after the Federal Election on the back of lower wage growth, property prices falling and also substantially subdued demand from Chinese investors. However, in the recent month, given the continual decline in borrowing costs arising from the RBA interest rate cuts, property prices have seen a small recovery. The Australian dollar has retreated to less than US70c and is expected to remain at that level, and even fall further should the Chinese economy further weaken as a result of their banking sector showing signs of implosion from bad debt. All these point to further strength in the gold price and potential weakness in the oil price, which has been trading below US$55/bbl.

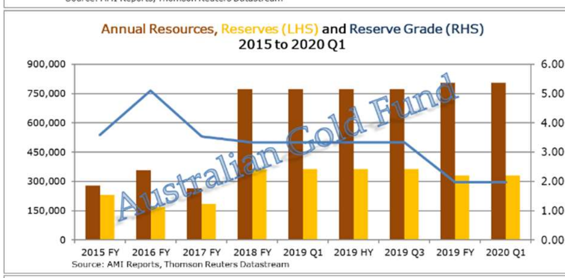
Operational and Financial Performance Charts

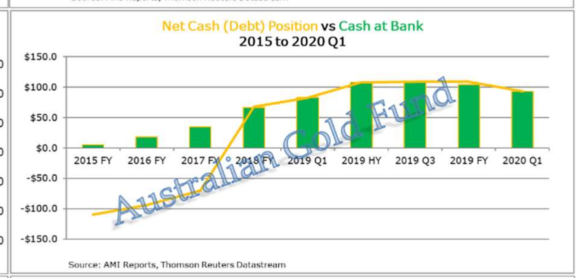


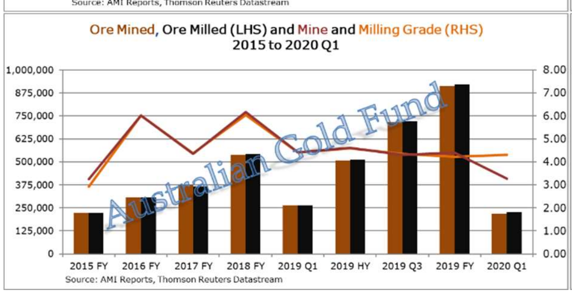


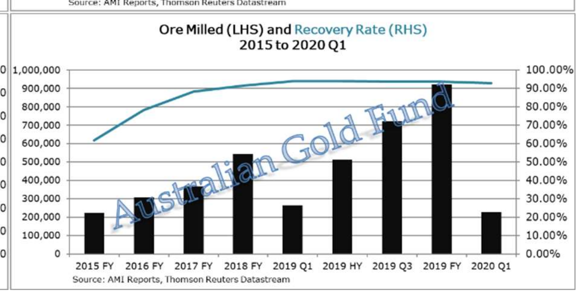








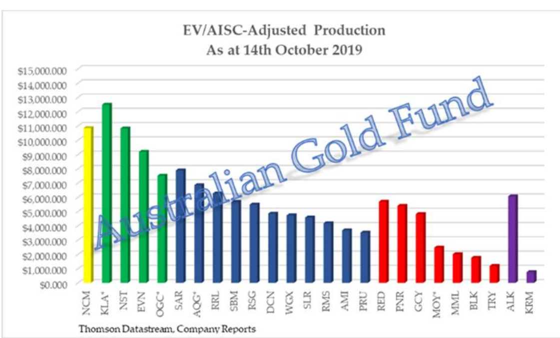


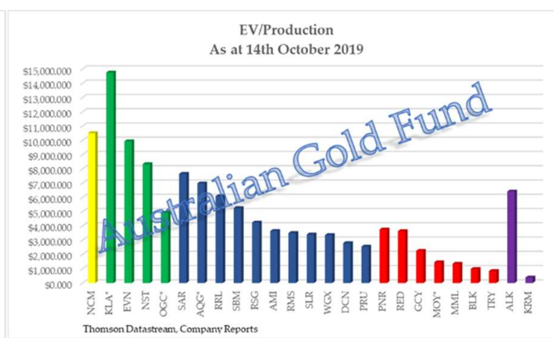


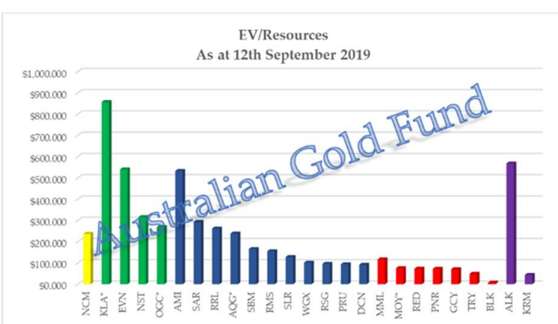
SWOT Analysis

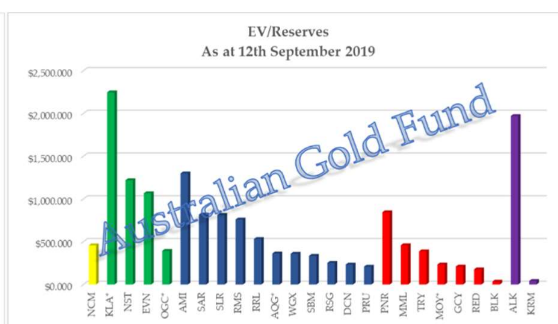
Strengths	Weaknesses
• Substantial cash balance providing opportunities for growth and expansion. • Diversified metals production allows for by-product credits and reduced mining costs as well as being able to capitalise on base metal price rallies.	• Weak market sentiment due to investor disappointment since April is expected to remain for some time and place pressure on stock price. • Low mine life and declining ore grades provide little upside for the longer term.
Opportunities	**Threats**
• Exploration campaigns with encouraging drill results may likely result in resource and reserve conversions in the coming year. • Cash reserves may be deployed for acquisitions to increase mine life and reserve levels.	• Lower ore grades from both mines may lead to higher mining costs as well as accelerating cessation of operations, notwithstanding further discoveries. • Investor patience wears very thin and any further disappointments could exacerbate another wave of selling.

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 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.

Given the rise in gold price in the recent three months, we see reason to re-rate the gold mining companies' valuation metrics upwards to reflect their improving profitability as well as increased enthusiasm from investors. As a rough guide, the fair value ranges for different mining company classes are as follows:

Major and Large Companies *- $8 000-$11 000/oz*

Mid-Tier Companies *- $3 000-$6 000/oz*

Micro and Junior Companies *- $1 500-$2 500/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 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

Declaration of Interest

The Australian Gold Fund and its directors currently hold Aurelia Metals stocks and may purchase prior to or subsequent to the report being published on their website. We do not receive any income or benefits from the company as a result of our report.