Australian Gold Fund Valuation and SWOT Analysis

Special Report on the Merger of Alacer Gold Corporation Limited (ASX: AQG) & Silver Standard Resources (TSX: SSRN)

Date	5/06/2020
Classification	Large Gold Miner
Current Price	$8.480
No. Issued Stocks (m) *Implied for AQG*	685.4
Net Cash + Bullion + 0.5 x GIC ($ m)	$352.20
Last Dividend Payment ($ p.a.)	$0.00
Market Capitalisation ($ m) *Implied for Combined Entity*	$5,812.03
Enterprise Value ($ m) *Implied for Combined Entity*	$5,459.83

Operating Performance Metrics	
Annual Gold Production Guidance *(Including Silver Resources)*	640 000-738 000
All-In Sustaining Cost Guidance *(Including Silver Resources)* **($/oz)**	$1 000-$1 200
Operating Margin (Sale Price less AISC)	$1,300.00
Resources (oz)	27,530,400
Reserves (oz)	8,628,550
Financial Year Cumulative Production (oz)	158,259
Production as % of Annual Guidance	22.94%
Financial Year Cumulative AISC ($/oz)	$1,537.75

Valuation Metrics	
Price Range	$6.74-$13.44
Overall Ranking	Undervalued
Current EV/AISC-Adjusted Production	$8,717.00
EV/AISC-Adjusted Production Range	$8 000-$12 000
Ranking	Undervalued
EV/Resources	$198.32
Ranking	Undervalued
EV/Reserves	$632.76
Ranking	Fair Value

Summary

Alacer Gold entered into an agreement with Vancouver-based Silver Standard Resources Mining (TSX: SSRN) on 11th May 2020 to execute an at-market merger to come into effect around July 2020. Under this arrangement, Alacer Gold shareholders will receive 0.3246 SSR Mining stocks for each Alacer Gold stocks they own. Based on the ratio of stock conversion in this transaction, Alacer Gold shareholders will own 43% of the merged corporation. The two companies merging together will result in them being a large gold and silver producer with four producing mines in the US, Canada, Turkey and Argentina and annual gold equivalent production of over 700 000oz (based on the company's ownership of their mines) at claimed AISC of US$900/oz (around A$1 400/oz). The company also will be expected to deliver substantial free cashflows from operations and have a balance sheet with substantial liquidity and in a net cash position. Our report values the company by adjusting the number of stocks issued in terms of Alacer Gold, even though the combined entity will be under SSR Mining.

Since completing the Copler sulfide processing plant in late 2018, the company has entered into a new phase of operations with exceptional mine life. The company delivered an attributable production of 312 971oz last year at AISC of just over A$1 000/oz, a substantial improvement to the 2018 result where they produced 170 865oz at AISC of A$822/oz. This year, the expected production from the Copler mine is 248 000-288 000oz attributable to the company at an AISC of around A$1 100-$1 175/oz as a result of a substantial reduction expected from the Copler oxide operations due to a revised mining plan, partly offset by the further ramp-up of the Copler sulfide operations. However, this may be subject to upgrading depending on the progress of the delivery of ore to the Copler oxide operations earlier than anticipated. The first quarter's production delivering 70 290oz attributable to the company at AISC of A$1 063/oz is on track. We note that this performance that is slightly ahead of the company's management guidance is in a quarter where the Wuhan/coronavirus affected global operations across virtually all industries and many mining companies had to operate with reduced teams. This is a positive signal that the management may be able to upgrade the 2020 guidance going forward.

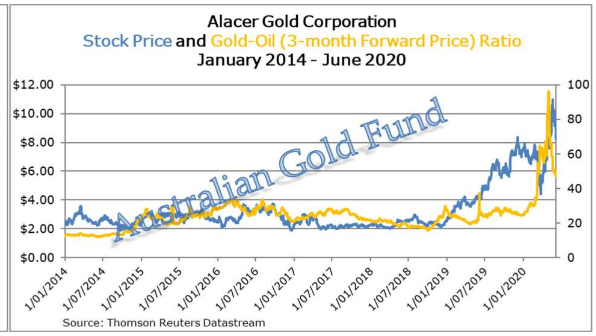
The company's balance sheet performance has again strengthened substantially as a result of its operations. The net debt position over the quarter improved by almost A$75m and the company would be on track to be in a net cash position as early as the June quarter. Within one year, the company reduced their net debt position by A$270m. This is an impressive achievement considering that during this same period, Evolution Mining improved their net cash position by almost A$230m and Evolution Mining produces at almost 2.5 times that of Alacer Gold.

With respect to the combined entity, SSR Mining had a market capitalisation of around A$3.5 billion and A$2.5 billion for Alacer Gold at the time this announcement was made. The merged entity would have a combined cash and marketable securities exceeding A$1.05 billion with debt of around A$760m, thus resulting in a net cash position of around A$345m. The company will have an enterprise value of approximately A$5.5 billion based on the most recent price and will comprise four operations – Copler in Turkey with an expected annual production of around 248 000-288 000oz this year at AISC of around A$1 100-$1 175/oz, Marigold in Nevada, US with an expected annual production of 225 000-240 000oz at cash cost of around A$1 200-$1 250/oz, the Seabee mine in Saskatchewan, Canada with an expected annual production of 110 000-120 000oz at cash cost of around A$700-$780/oz (though the company suspended operations in late March as a result of the pandemic) and the Puna mine in Argentina that is expected to produce 6-7 million oz of silver (gold equivalent ounces of around 100 000-120 000oz) at cash cost of A$15.50-$18.50/oz of silver produced. Using SSR Mining figures, their 2020 management guidance was originally 400 000-450 000oz and using the AISC of the first quarter of US$1 262/oz or A$1 850/oz, we believe that the combined entity's implied guidance for this year would reasonably stand at 640 000-738 000 at AISC $1 000-$1 200/oz, owing to the lower cost of production for the Copler mine and also the potential for higher silver prices later this year that will offer by-product credits.

In terms of the combined entity's future operating potential in terms of the Mineral Resources and Ore Reserves, these will increase to 8.6Moz and 27.5Moz, respectively. This volume is in line with the ASX-listed peers such as Northern Star (9.0Moz and 26.6Moz), Kirkland Lake Gold (23.0Moz and 39.2Moz), Evolution Mining ex-Cracow (8.6Moz and 20.8Moz) and Saracen Mineral Holdings (7.0Moz and 15.7Moz). The Copler mine has a processing plant that is able to process approximately 2.3Mt p.a. of oxide ore and 1.9Mt p.a. sulfide ore, with an expansion of the heap leach pad to allow for processing up to 6Mt p.a. of ore in total to occur in the near future. The Seabee mine is characterised by very high ore grades exceeding 10g/t while the Marigold mine has low grades but the costs are controlled by way of a 20+Mt p.a. processing plant offering economies of scale. The Puna mine has a 1.5Mt p.a. processing plant that produces silver, lead and zinc.

In our calculations, we have decided to use the equivalent number of issued stocks for Alacer Gold in the combined entity. This would equate to Alacer Gold trading with around 685.4 million stocks (almost 2.33 times the number of outstanding stocks of the company to give the ownership ratio between Alacer Gold and SSR Mining shareholders to be 43:57. Based on this, we also considered that the company will be a large producer and hence justify a higher valuation multiple. We have taken into account the combined entity's cost profile and expects that the EV/AISC-Adjusted Production multiple would be around that of the large producers at $8 000-$12 000/oz. At the current stock price, the implied metric stands at $8 717/oz, implying it is at the lower end of the range. The EV/Resources and EV/Reserves multiples are $198/oz and $633/oz, respectively. This places the company as being undervalued relative to its rather large resources base and being fair value relative to its reserves. Taking all of these in account, we believe the company is undervalued. However, given the Seabee mine has suspended operations and has not yet resumed, this is a significant risk to the company's operating performance going forward.

Prevailing Environment

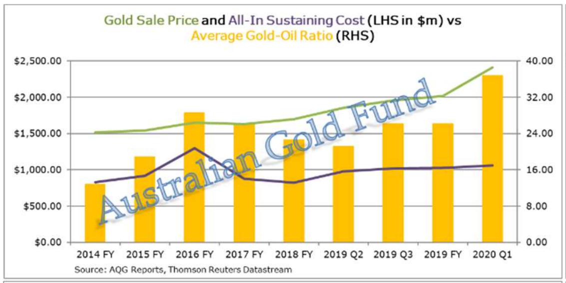


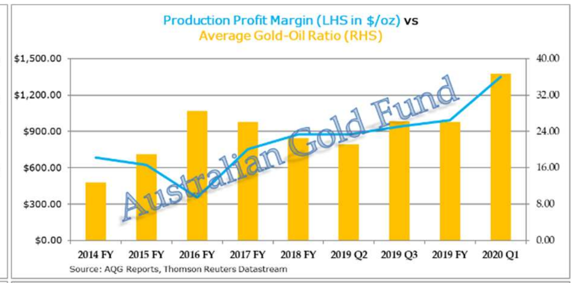
The recent four months have seen the world and the global financial markets face some monumental events that have made a lasting impact, and will expect to steer the world in a different trajectory hereafter. A combination of events starting with the US-Iranian conflict (who still remembered this?) in early January, the spreading of the coronavirus leading to a pandemic starting late last year, the collapse of OPEC talks in early March and then the sharp global market crash from late February to March have shaken nations, corporations and households alike. In the midst of this, most market indices around the world declined 25-40%, most commodity prices fell (except for gold) and so did cryptocurrencies (though some have bounced to back and more). The Federal Reserve cut their interest rate to 0-0.25% by mid-March, bringing them back to late-2008 at the onset of the subprime crisis. In addition, the Federal Reserve Board of Governors has indicated that they will have almost unlimited capacity to create currency to monetise debt in the bid to prevent the economies and markets from imploding. Other central banks have followed while the Reserve Bank of Australia has cut rates to 0.25%. Governments have announced stimulus packages and foreshadowing tax cuts to aid small businesses and households facing national lockdowns that have brought many cities to a standstill.

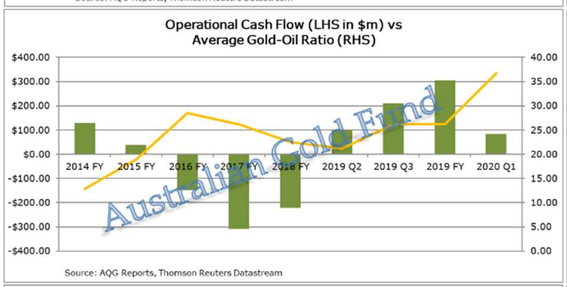
In the midst of all this, the gold price has seen a steady rise during this period with a short yet violent decline for a few days in March when it went below US$1 500/oz. However, gold demonstrated its safe haven status, laying claim to being one of very few assets that saw its price stand strong during the market-wide sell-off. The gold price started the year at US$1 520/oz and traded during this period in the US$1 460-$1 750/oz range. In Australian dollar terms, gold has broken out on the upside, starting the year at A$2 163/oz and peaking at over A$2 800/oz as the Australian dollar dipped to as low as US$0.56. However, we have recently seen the Australian dollar recover substantially over the last three weeks as it approaches US$0.70, possibly as the effects of the stimulus in the US flowing through and hence leading to the US dollar to fall. The gold price has also fallen to just below US$1 700/oz as positive surprises in the economic data relating to the US Bureau of Labour Statistics for May contributed to markets entering again into a risk-on mode. We place a caveat on these data as it is based on flawed assumptions and economic definitions, but we recognise that the market follows these optics.

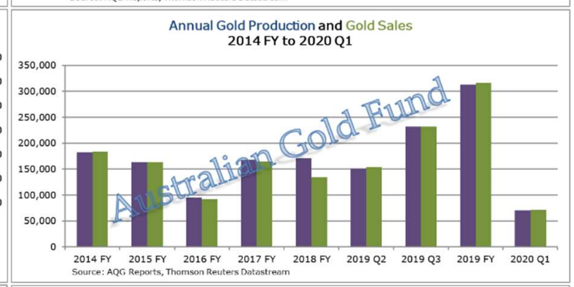
The oil price has also seen a historic crash from US$64/bbl in early January to US$16.60/bbl in late March. However, the spot price for WTI crude oil went outdid its decline and fell to -$37.63/bbl on 20th April, an unprecedented and inconceivable event (imagine at one stage a pack of toilet paper is cheaper than a barrel of oil, go figure!). Over the month of May, the oil price has staged a dramatic recovery and has risen over US$40/bbl at one stage. The gold-oil is currently in the 45-50 range after having gone over 100 at one stage. We expect that the oil price to trade in the US$30-55/bbl range during most of this year as countries resume normal trading activity, with geopolitical tensions and social unrest potentially leading to risk-off behaviour and commodity prices possibly jumping in either directions.

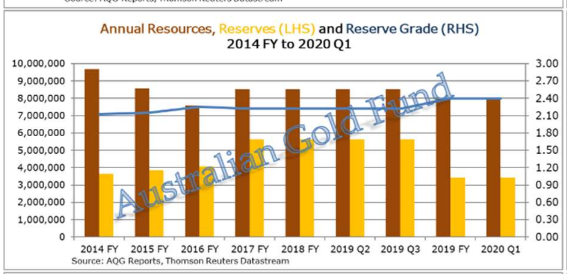
Operational and Financial Performance Charts

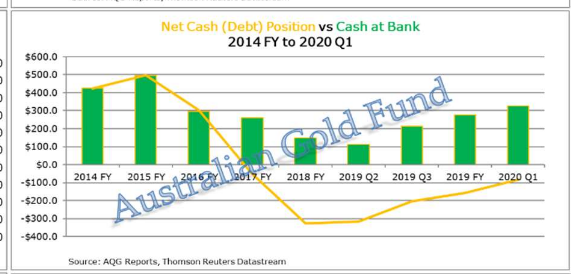


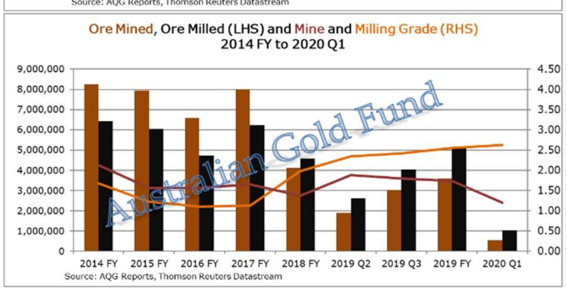


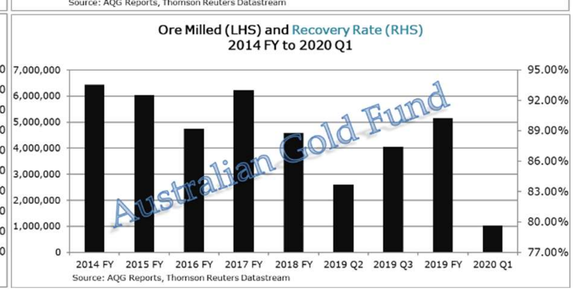








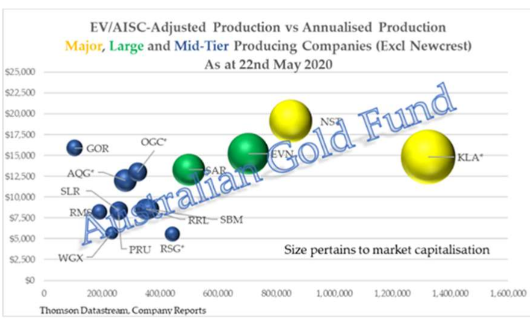


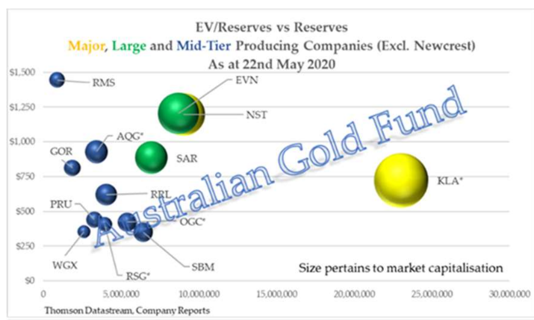


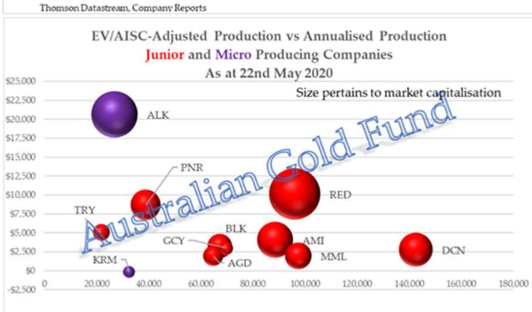
SWOT Analysis

Strengths	**Weaknesses**
• Combined entity offers diversified operations producing gold, silver and base metals across three continents that also seem to provide complementary benefits for both entities. • Strong balance sheet with potential to acquire other companies or mines as well as grow organically on their existing properties. • Competent management with track record for both companies.	• With the exception of the Copler mine, the other three mine operations are smaller scale. • Almost half of the combined entity's operation (Copler) is in a country that is becoming increasingly authoritarian.
Opportunities	**Threats**
• Further acquisitions are possible given the current bullish sentiment in the precious metals mining industry and many cash-strapped exploration companies needing a white knight. • Higher gold price will increase the company's profit margin and allow for a re-rating.	• Souring relations between Turkey and the US, Australia or Canada could lead to Turkish government interfering with operations or even ownership of the Copler mine.

Peer Comparison







Valuation Thesis

Our key valuation metric is the **EV/AISC-Adjusted Annual Production** as we have found in our empirical study that the market valuation is most aligned to this metric, as opposed to earnings, resources and reserves. We also prefer a multiples method over the typical Discounted Cashflow Method for valuation because we understand that beyond even one year of projection, everything is highly speculative – whether it is the management outlook on production and costs as well as the gold price and broader economic drivers. To allow for comparison across all classes of producers, our metric can standardise by the company's scope of production as we observe that the market values the companies with higher production with a greater multiple. However, we scale production by AISC 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. 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 metric quantifies 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.

When determining the production ranges in our valuation metric, we take the management guidance as this is based on their access to information relating to their operations and progress. We believe that the market will use the guidance figures to base their valuation and investment decisions. This may not always be optimal given that some management may have their bias in reporting their outlook, as well as having a track record of announcing surprises. In such cases, we seek to qualify this in our SWOT analysis and adjust it in our EV/AISC-Adjusted Production multiple.

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.

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 are dubious in terms of additional 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 while a company with substantial resources and reserves have potential to convert into substantial value in future, this is contingent on the successes in 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, but we have tried and tested our valuation against the actual price performance as well as through our own investment performance. We let these results speak for themselves.

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-$12 000/oz*

Mid-Tier Companies *- $4 000-$7 000/oz*

Micro and Junior Companies *- $1 500-$4 000/oz*

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.

Disclaimer

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Declaration of Interest

The Australian Gold Fund and its directors currently own Alacer Gold stocks and may trade them 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.