Australian Gold Fund Valuation and SWOT Analysis

Stock Valuation Report
Blackham Resources Limited (ASX: BLK)

Date	8/11/2019
Classification	Junior Gold Miner
Current Price	$0.012
No. Issued Stocks (m)	4,407.2
Net Cash + Bullion + 0.5 x GIC ($ m)	-$2.47
Last Dividend Payment ($ p.a.)	$0.00
Market Capitalisation ($ m)	$52.89
Enterprise Value ($ m)	$55.36
Resources (oz)	6,381,000
Reserves (oz)	1,380,000

Ranking	**Undervalued**
Price Range	$0.009-$0.023
Annual Production Guidance (oz p.a.)	70 000-80 000
All-In Sustaining Cost Guidance ($/oz)	$1 550-$1 750
EV/AISC-Adjusted Production Guidance ($/oz)	$1,218.00
EV/AISC-Adjusted Production Range ($/oz)	$1 000-$2 000
EV/Resources ($/oz)	$8.68
EV/Reserves ($/oz)	$40.12

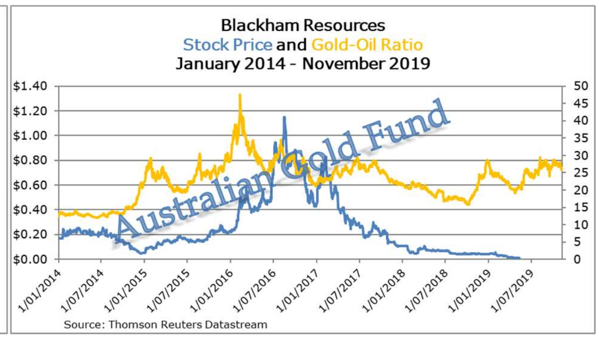
Summary
Blackham Resources is a junior mining company that has a substantial mine at Matilda-Wiluna, but has been facing longstanding operational issues since it began production in 2017. The company has also raised equity capital in September for approximately $7m, $4m from an institutional capital raising and $3m from a share purchase plan, in order to increase their working capital to finance the first stage of the development project. The September quarter production results appear to be more encouraging, with cashflows generated from operations net of administration costs of approximately $7.3m as production costs fell. Given the company's unpredictable operating history and several disappointments, we hold a highly cautious view on their outlook and will need to observe two more quarters of results to be sure a turnaround is confirmed.

Blackham ended the 2019 financial year with production of 65 406oz at AISC of $1 778/oz, which was well below the start of year guidance of 77 000-89 000oz at AISC $1 250-$1 450/oz. The company's downgraded guidance was 66 000-68 000oz at AISC $1 700/oz. The June quarter was particularly disappointing with production at 12 045oz at AISC $2 376/oz spanning from lower ore milled. By the end of the financial year, the company's cash balance fell to $0.69m, bullion at $2.9m and total debt at $12.1m. The financial position appeared dire at this time, requiring the company to continue to sell down some of their non-core mine assets and raise $10m through another dilutive capital raising at 1c. Things have appeared to be more stable with the September quarter results registering 17 565oz of production at AISC of $1 519/oz. The ore grade extracted from the mine improved substantially to 1.6g/t across the open-cut and underground mines, while the ore milled increased from 348kt at 1.3g/t to 420kt at 1.6g/t. This level of ore grade is a sharp increase compared to its production history thus far, and is worth paying attention to in the coming quarters. We do not take this for granted, at this stage, owing to the hostile operating environment in this site on the past.

Based on the guidance released in early August, Stage 1 is expected to commence for the 2021 financial year. Progress is under way with the Williamson expansion plans that will transition the company from free-milling to building a 4Mt p.a. processing plan that will produce up to 250 000oz p.a. The company is installing a sulfide processing circuit as the first stage of its capital development project, with the final report on plans to build the sulfide concentrator to be completed in the December quarter and also the tailings storage facility construction commencing. The first stage is expected to bring annual production to 100 000-120 000oz but based on the annual guidance of 70 000-80 000oz for 2020, this is not expected to be accomplished during this year. The note also expects that the Williamson expansion plans to cost $15m with maintenance capital expenditure in the construction of the concentrator and tailing storage facilities to cost $11m and $5m is expected to be spent on the refurbishment of the Rod Mill. Funding for this is expected to come from a combination of the rights issue and proceeds from sales of the Lake Way transaction to Salt Lake Potash Limited.

In the financial position and balance sheet side, Blackham Resources is now looking to be in a better position as the company has increased their cash balance through a combination of positive operating cashflows, rights issue and sale of non-core assets. The company currently still has $9.5m of debt to be repaid. Once the Lake Way sale is settled and the remaining balance of $7m has been received, then the company will be in a net cash position. However, from its history, Blackham Resources has developed the unfortunate reputation of running down their cash balance quickly in a matter of one quarter, and even through consecutive quarters, as a result of high production costs or capital expenditures that have not seen subsequent deliverables. Whether the tide has finally turned requires monitoring.

In light of the company now having a better balance sheet, early evidence of improved operations for this recent quarter and the gold price rising substantially in the last half a year, we have re-rated the company upwards but remain very cautious. At the current stock price of $0.012, we believe that it sits at the low end of our fair valuation range. We perceive significant risks regarding the company's operations remain and await the company management rebuilding its credibility with the market.

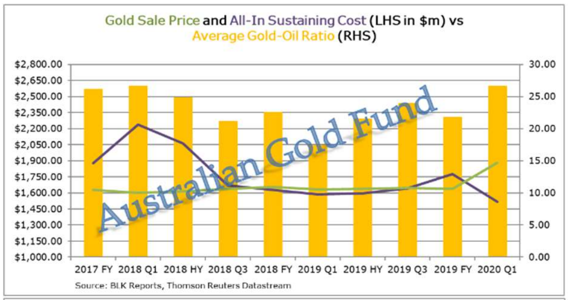


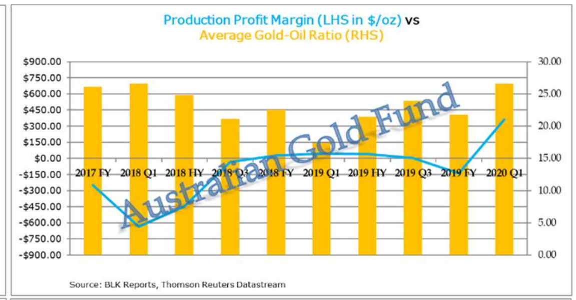
Prevailing Environment

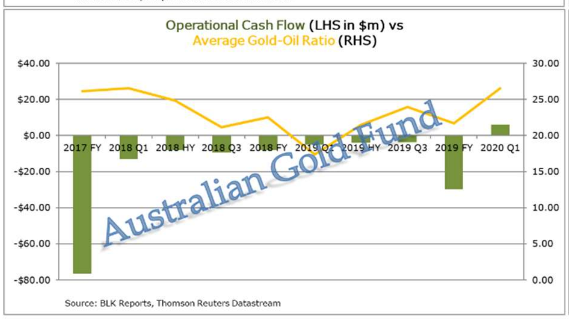
The gold price has remained above US$1 400/oz or A$2 000/oz since end of May 2019 when the central banks around the world abandoned their strategy to normalise their monetary policy but resumed reducing rates in light of further signs of economic weakness. The chronic effects of the financial system 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.

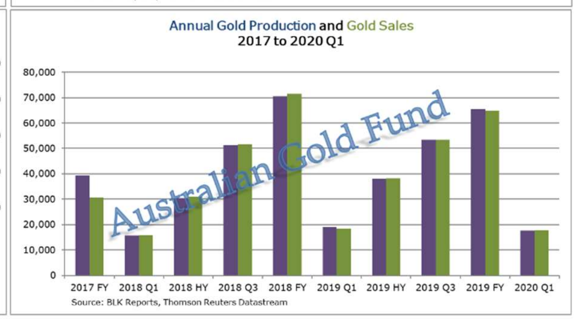
In Australia, the Reserve Bank has cut interest rates three times since June 2019 with the latest cut in October bringing the 24-Hour Cash Rate to 0.75%. The Australian economy has continued to show signs of weakness after the Federal Election on the back of lower wage growth, property prices falling 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.

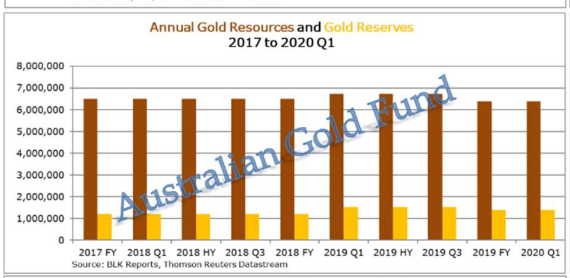
Operational and Financial Performance Charts

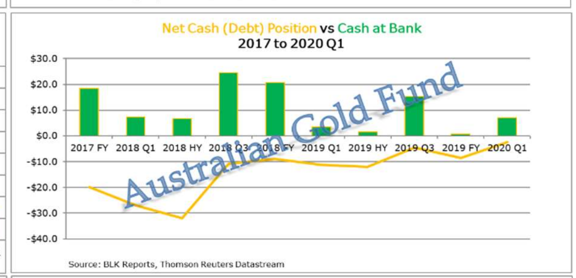


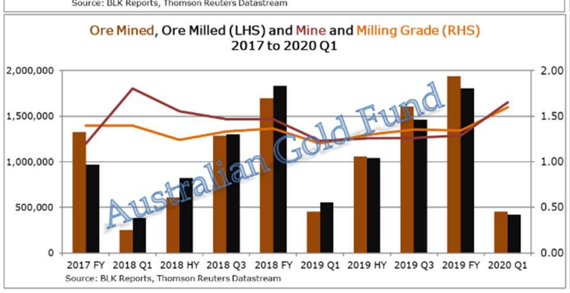


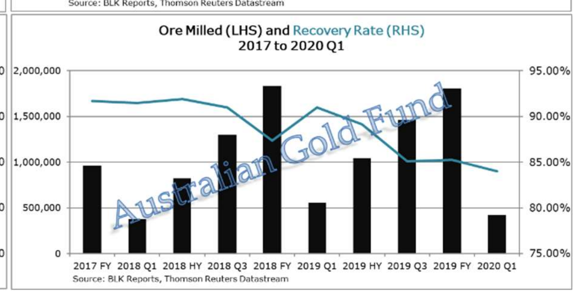








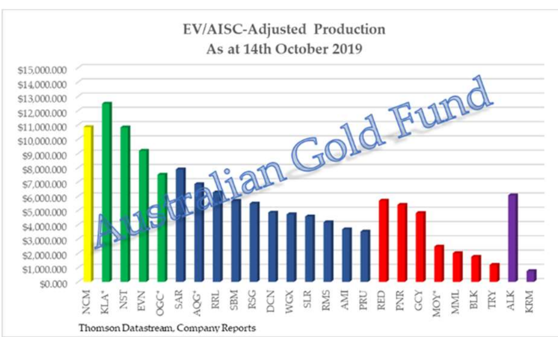


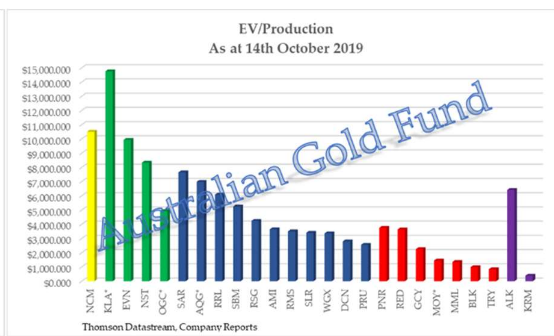


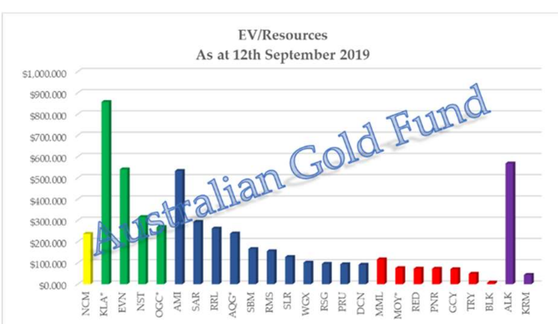
SWOT Analysis

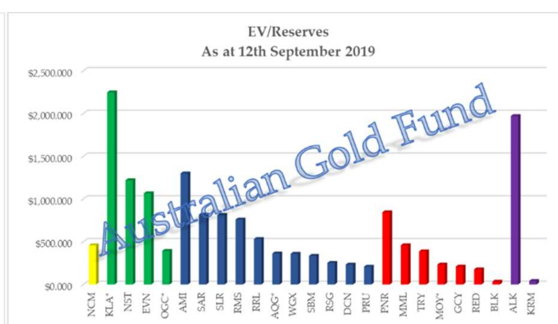
Strengths	Weaknesses
• Stock price implies company may be undervalued, with substantial growth potential should the development plans be completed. • Substantial reserve and resource in the Matilda-Wiluna site that can allow for long mine life, albeit slow in its development.	• Poor history of operational efficiency with the mine production and costs being unstable. • Management had been too optimistic about their plans and ended up levering up the company resulting in substantial equity capital dilution.
Opportunities	**Threats**
• Stage 1 expansion plan will see production increase substantially and costs will decrease, allowing for greater cashflow production. • Improvement in mined grades and processing of softer and richer ore appear to be manifesting itself now.	• Further delays in accessing richer ore veins and any operational equipment failure will further threaten the company's financial and liquidity position.

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

Information in this report is not intended to be financial advice and should not be used as such. While every effort is made to ensure the information is reliable and accurate, errors and omissions may still exist. The interpretation of financial reports, market announcements and management commentary is subject to personal views and discretion. Users of this report are highly advised to seek professional financial advice before making their decisions.

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