The Sydney Contrarian Financial Analysis

Stock Valuation Report

Evolution Mining Limited (ASX: EVN)

Date	8/10/2019
Classification	Large Gold Miner
Current Price	$4.660
No. Issued Stocks (m)	1,697.1
Net Cash + Bullion + 0.5 x GIC ($ m)	$63.96
Last Dividend Payment ($ p.a.)	$0.095
Market Capitalisation ($ m)	$7,908.34
Enterprise Value ($ m)	$7,844.39
Resources (oz)	14,725,000
Reserves (oz)	7,457,000

Ranking	**Fair Value**
Price Range	$3.67-$5.17
2020 Annual Gold Production Guidance (oz p.a.)	725 000-775 000
2020 All-In Sustaining Cost Guidance ($/oz)	$890-$940
EV/AISC-Adjusted Production Guidance ($/oz)	$9 467
EV/AISC-Adjusted Production Range ($/oz)	$8 000-$10 000
EV/Resources ($/oz)	$532.73
EV/Reserves ($/oz)	$1,051.95

Summary

Evolution Mining delivered a strong June quarter set of results, with production and costs being below that in the previous two quarters, though not as strong as the first quarter of the 2019 financial year. Production for the June quarter across the six operating mines was 194 886oz at AISC $915/oz, bringing annual results to 753 001oz at AISC $924/oz. Compared to the previous three years, the company has seen production trend downwards. However, this is due to Evolution Mining having offloaded the Edna May and Pajingo mines since 2016, and purchasing the Ernest Henry mine in 2017. With strong cashflow generation from operations and a modest repayment of their debt, the company now has a net cash balance.

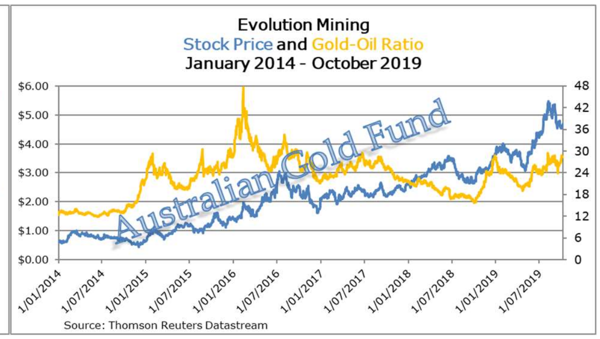
The 2019 financial year was nonetheless a rather strong year for Evolution Mining despite the company's operations having reduced compared to the previous years. Part of this was due to the weaker gold price and rising oil price in the first half of the financial year placing pressure on the production margin. However, Evolution Mining managed to continue to generate operating cashflows and increase their cash balance almost every quarter. While a number of gold mining companies downgraded production guidance during the year, Evolution Mining went against the trend and upgraded their guidance from 720 000-770 000oz to 725 000-775 000oz and eventually delivered at the midpoint of the guidance range. This is no mean feat as the financial year proved to be somewhat challenging for the gold producing companies for a large proportion of the year, until the gold price began to rally in late May as a result of the central banks changing their stance on their monetary policy in light of the weakening level of market stability observed around the world.

While Evolution Mining offloaded two mines over the last three years, they have continued to increase their ore reserves and mineral resources through exploration. Much of this is in their flagship Cowal mine where resources have grown by over 2Moz while reserves have increased by 1Moz. The company continues to invest substantial capital into developing the Cowal mine with a view to increase annual production for this mine from 250 000oz p.a. to over 300 000oz p.a. The Ernest Henry mine has also delivered strong performance, with record mine cashflow generation or the year. The two high grade mines, Cracow and Mount Carlton, are still maintaining steady levels of production though the resources and reserves are depleting, even though less than the annual production. The Mungari mine reserves have depleted gradually though the reserve grade is declining faster. At the same time, the 2020 annual guidance shows similar decline in production while the AISC is expected to increase.

As a large gold producing company, Evolution Mining has been one of the steadiest performers over the year when peers Northern Star and Oceanagold upsetted investors with shock announcements regarding their operations. Only Kirkland Lake Gold managed to surpass Evolution Mining in this case. This explains why despite Northern Star delivering higher production, has a higher net cash position and more resources, Evolution Mining has a higher market capitalisation. Going forward, Evolution

Mining looks to be increasing their production in an organic manner. However, as they now have cash balance exceeding their total debt, they may consider acquiring other mining companies to increase both their production and ore reserves. Many options are available for the Board to decide how to build their business further. Evolution Mining is one of the most diversified gold mining companies on the ASX and hence provides a steadier option for investors wishing to have exposure in the gold mining industry.

At the current stock price of $4.66, the company’s EV/AISC-Adjusted Production stands at around $9 470/oz. Taking into consideration a more accommodative environment for gold mining companies as a result of a higher gold price, lower oil price and further expectations of a weakening Australian dollar, the current price sits within an upgraded fair value range of $8 000-$10 000/oz. Any acquisitions may provide catalyst for future growth, as long as the price paid is within a reasonable range relative to production level, AISC and reserves.

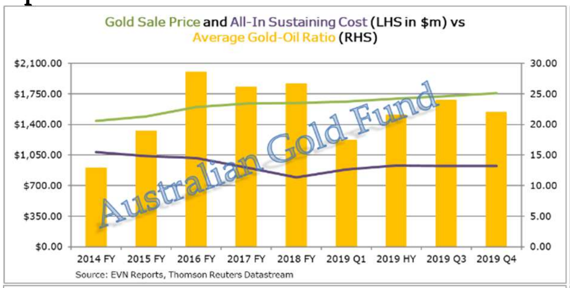


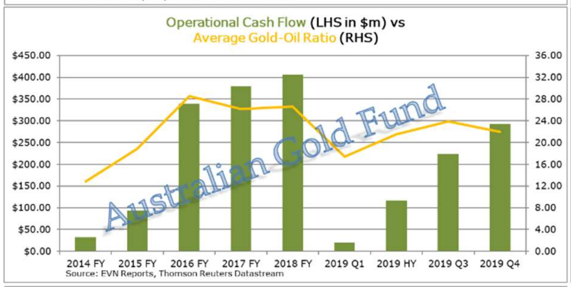
Prevailing Environment

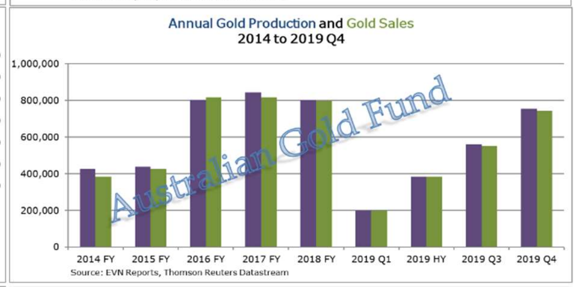
The gold price has continued to remain strong since the sharp rally commencing during June as a result of the change in the monetary policy stance from the Federal Reserve from seeking to raise rates even at the end of last year to signalling they would begin reducing the Federal Funds Rate. The first cut came at the end of July in their FOMC meeting, bringing the Federal Funds Rate down to 2-2.25%. Another rate cut came in mid-September, with the FFR falling to 1.75-2%. Further rate cuts are expected and in early October, the Federal Reserve announced their intention to resume currency printing as a means to revive the economy that appeared to have two tracks. On one hand, headline economic growth and unemployment in the US appear encouraging, with the unemployment rate falling to 3.5% in September. However, business confidence, consumer spending and borrowing activities have slowed down. Media headlines appear to be mystified by this and are calling for potential recession next year. However, much of what they report appear to be out of line with the fact that they also report record market levels. This is an unprecedented period of "market schizophrenia" in that narratives are diametrically opposite depending on what data points are used.

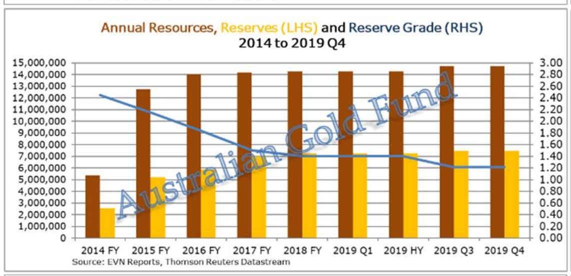
Corresponding with the confusion over the global economy and financial markets is the continual steadiness in the USD gold price maintaining above $1 500/oz, while the AUD gold price has maintained over $2 150/oz. This is partly due to the central banks trending towards easy monetary policy once more, after a brief period of seeking to return the financial markets to normal conditions. The oil price movements have been interesting, especially the geopolitical tensions in the Middle East with regards to the Iran drone shooting and also the Saudi Arabian oil field attack. The oil price initially spiked to over US$60/bbl but after President Trump announced the release of the nation's strategic oil reserves, the oil price subsided. Furthermore, with business and consumer confidence being somewhat tepid, the oil price has continued to decline to the low $50 range. These conditions are favourable for mining companies, and especially with gold producing companies that can enjoy a more generous production margin.

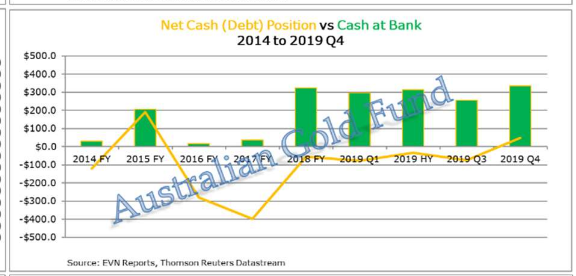
Operational and Financial Performance Charts

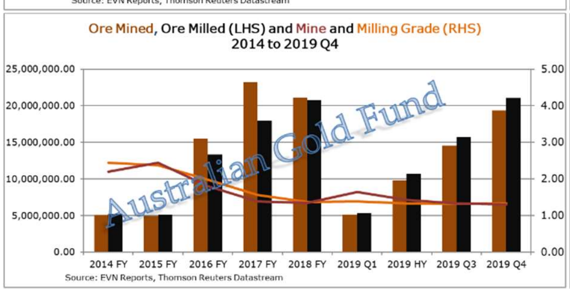


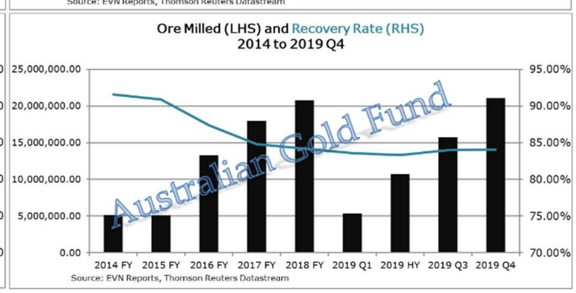










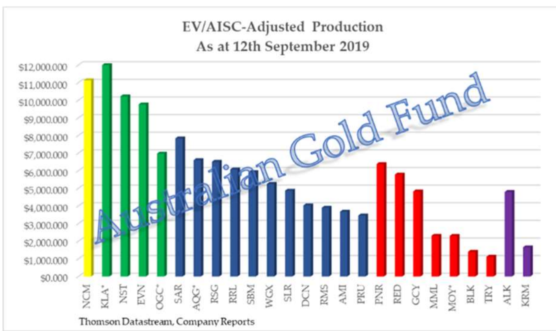


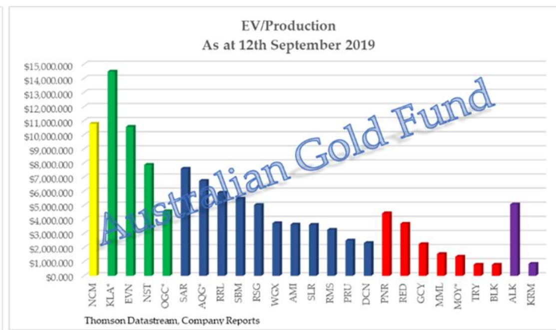
SWOT Analysis

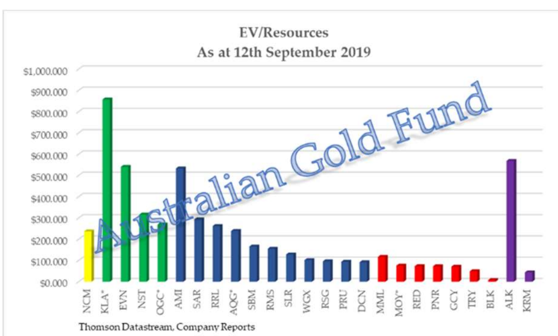
Strengths • Diversified operations across six mines that have a relatively low-cost base. • Management has proven track record in delivering performance over a difficult market over the last seven years.	**Weaknesses** • Company has been hesitant in making acquisitions the last two years even as their peers have been expanding by purchasing other mining companies.
Opportunities • Evolution Mining has a solid balance sheet that offers flexibility to finance further acquisitions. • A 14.7Moz resource base has significant potential to convert into reserves with the high gold price currently.	**Threats** • Legacy mines such as Mount Rawdon and Cracow may see costs rise further. • Ore grades are reducing and the company is processing higher grade ore now, potentially threatening sustainability of the ore that is not yet extracted.

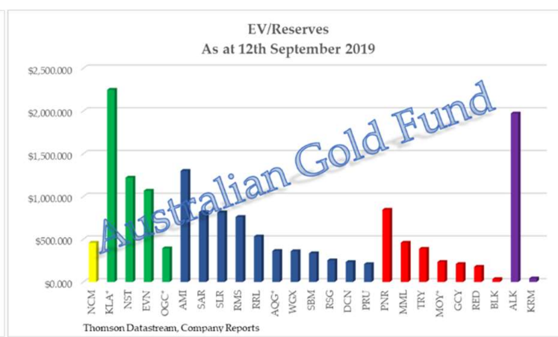
• The Marsden deposit has not been given much attention despite having a not insignificant reserves and resources base.	

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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