Australian Gold Fund Valuation and SWOT Analysis

Oceanagold Corporation (ASX: OGC)

Date	24/05/2019
Classification	Large Gold Miner
Current Price	$3.950
No. Issued Stocks (m)	622.3
Net Cash + Bullion + 0.5 x GIC ($ m)	-$76.75
Last Dividend Payment ($ p.a.)	$0.03
Market Capitalisation ($ m)	$2,457.99
Enterprise Value ($ m)	$2,534.74
Resources (oz)	8,680,000
Reserves (oz)	5,949,500

Ranking	**Fair Value**
Price Range	$2.745-$4.705
Annual Production Guidance (oz p.a.)	500 000-550 000
All-In Sustaining Cost Guidance ($/oz)	$1 190-$1 260
EV/AISC-Adjusted Production Guidance ($/oz)	$5,914.39
EV/AISC-Adjusted Production Range ($/oz)	$4 500-$6 500
EV/Resources ($/oz)	$292.02
EV/Reserves ($/oz)	$426.04

Summary

Oceanagold has been undertaking a series of developments in their mines in the view to extend their productive life. This development stage has seen the Didipio mine commence production from its underground deposits, as the surface mining has pretty much ceased. The Waihi mine is also at the stage of developing their underground deposits. The company is expecting this year’s production level will fall from 533 286oz in 2018 to 500 000-550 000oz for this year, with the AISC increasing as well. As a result of the development being under way, the first quarter has fallen to 125 681oz at an elevated AISC level of A$1 440/oz. This compares with last quarter’s production of 126 656oz at AISC $1 140/oz.

The stock price of Oceanagold has fallen almost 25% since the start of the year when it peaked at $5.26. The change in the investor sentiment has occurred as the December 2018 quarterly report and the March 2019 quarterly report showed that the company is at its developmental stage, resulting in lower production volume and higher AISC than the June 2018 and September 2018 quarterly reports that pointed to strong performance. Furthermore, the gold-oil ratio began to fall early this year as the oil price increased almost 33%, which raises the operating costs of mining companies in general.

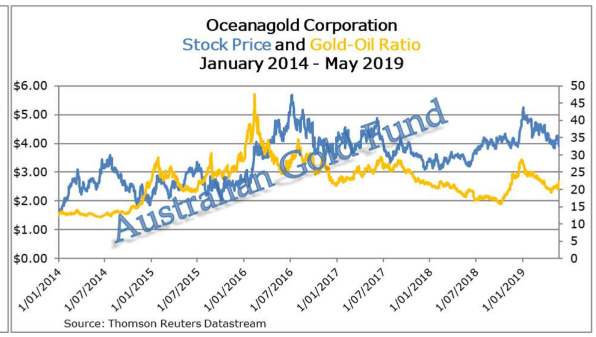
Though Oceanagold has highlighted both the Didipio and Waihi mines are undergoing development with its underground mines being constructed, the cause for concern is in the Haile mine where the AISC has increased to A$2 500/oz when it was as low as A$711/oz for the June 2018 quarter. While more ore was processed during this quarter, the ore grade dropped by almost 40% from last year and thus contributed to escalated costs. The company attributes the Haile mine underperformance to excess rainfall leading to difficult operating conditions and expects a turnaround in the coming quarter.

The Didipio mine is worth commending with production at 33 636oz at AISC of $895/oz with 30% of the ore fed to the processing plant being from underground pits. While ore grade is lower this quarter than last December, the underground grades have been improving and it is expected that the higher-grade underground ore will be fed into the mill in the second half of the year. Copper production has improved from last quarter. Combined with improving gold ore grade and more underground ore being fed to the mills, the AISC is expected to decrease in the coming quarters, hopefully returning to below A$500/oz by the end of the year.

The Waihi mine is undergoing development as the Martha and WKP Projects are being drilled and ore will source from there. This quarter’s performance was detrimentally affected by low equipment availability and a decrease of ore being fed to the mill by around 10% from the previous quarter. However, the company expects the next quarter to experience improved grades and higher mill feeds. The AISC escalated to A$1 386/oz but part of this is also attributed to capitalised mining costs from their development projects.

The Reefton/Macraes mine production and AISC reverted back to the levels seen in 2018, with production of 51 215oz at AISC of A$1 252/oz. Thus, the December quarter was an aberration when production spiked to 58 241oz at AISC A$958/oz. The company appears to have increased the amount of ore mined to 2.086Mt but the processing capacity has not changed too much to average around 5.6Mt p.a. The company is expected lower production for the next two quarters but turning around at the last quarter of 2019.

Overall, Oceanagold has been a mixed bag in terms of its performance as they continue to undergo further development to extend their mining life and increase production. Operational difficulties affecting the Haile mine has contributed to the AISC rising substantially. The company's stock price fell as the company's management guidance for this year appears subdued after a solid 2018. The company has been downgraded from the previous report last December 2018 and is considered priced at fair value at the current stock price of $3.95. As its development projects prove itself and production increases above 600 000oz p.a., the company will likely be rerated upwards.

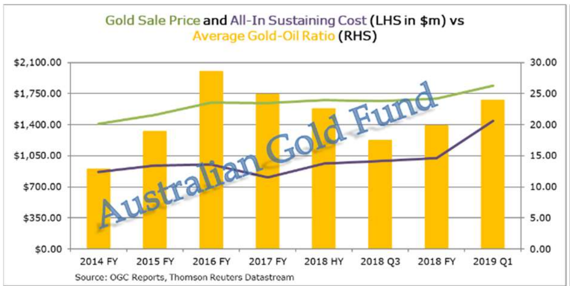


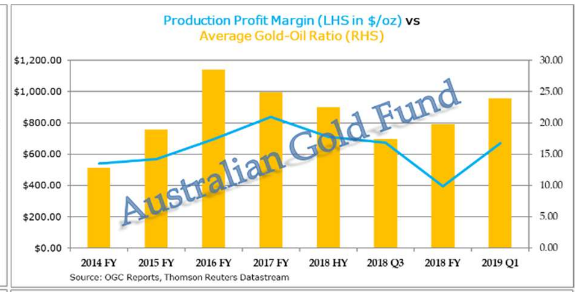
Prevailing Environment

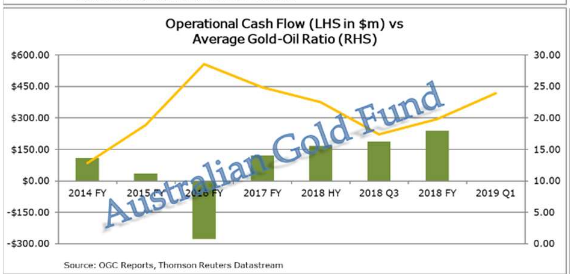
The March quarter has been a challenging one for many gold mining companies despite the gold price trading in the US$1 280-1 345/oz and A$1 790-1 880/oz range. Part of this is caused by the oil price rising 33% from US$45/bbl to US$60/bbl during the quarter, leading to the gold to oil ratio placing some 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.

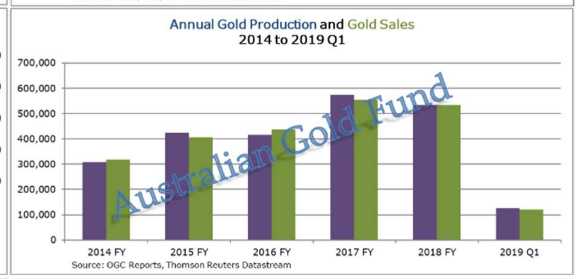
Since the end of the March quarter, the gold price has further weakened while the oil price has increased. The gold to oil ratio has fallen to the 20-21 mark, but there are signs that the gold price is nearing a bottom while the oil price is falling. The months of April and May tend to be cyclical bear periods for gold, with June and July seeing its price recover. This may be repeated in 2019 as the global stock markets are again approaching a peak.

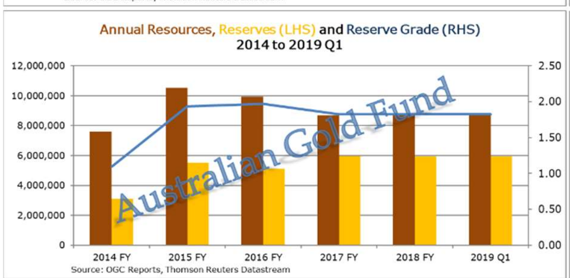
Operational and Financial Performance Charts

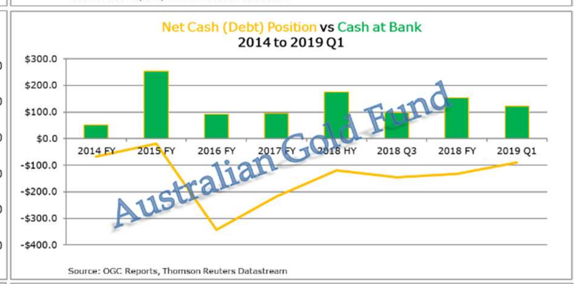


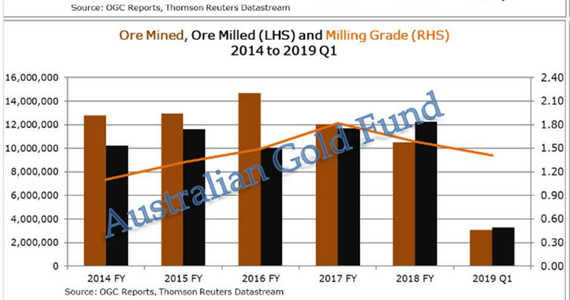


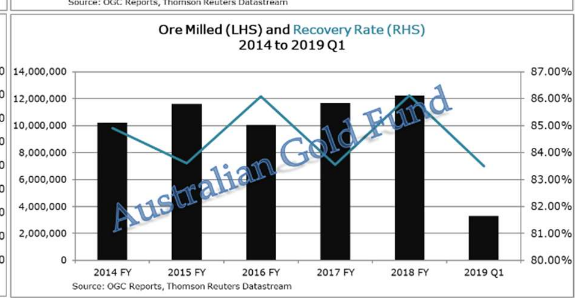








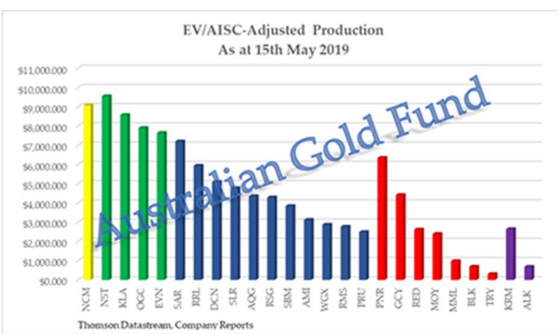


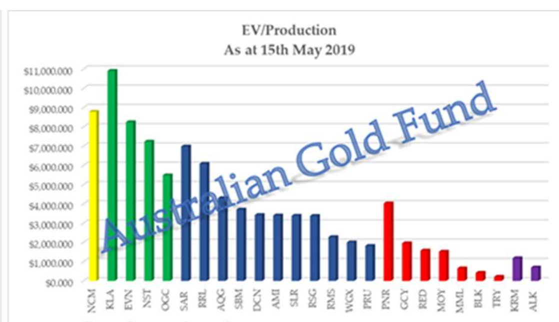


SWOT Analysis

Strengths	**Weaknesses**
• Four gold mine operations in New Zealand, USA and Philippines with development potential. • Proven track record in developing and acquiring good quality mines.	• Both the Waihi and Haile mines have been producing at reducing levels and increasing costs. • The company's resources and reserves in their existing properties have been relatively stagnant in the past three years, after accounting for depletion.
Opportunities	**Threats**
• The Haile mine has substantial reserves still to be exploited. • The Didipio underground expansion project should provide a new lease of life for the company's operations in the Philippines, generating low cost gold and copper.	• The company faces the threat of higher operating costs as it expands on its mines that may place it further into debt, reducing their financial flexibility.

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.

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 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.