Australian Gold Fund Valuation and SWOT Analysis

Perseus Mining Limited (ASX: PRU)

Date	25/07/2019
Classification	Mid-Tier Gold Miner
Current Price	$0.725
No. Issued Stocks (m)	1167.4
Net Cash + Bullion + 0.5 x GIC ($ m)	$124.81
Last Dividend Payment ($ p.a.)	$0.00
Market Capitalisation ($ m)	$846.40
Enterprise Value ($ m)	$721.59
Resources (oz)	7,280,000
Reserves (oz)	3,464,000

Ranking	**Undervalued**
Price Range	$0.585-$1.025
2020 Annual Gold Production Guidance (oz p.a.)	260 000-300 000
2020 All-In Sustaining Cost Guidance ($/oz)	$1 120-$1 400
EV/AISC-Adjusted Production Guidance ($/oz)	$3,245.00
EV/AISC-Adjusted Production Range ($/oz)	$3 000-$4 000
EV/Resources ($/oz)	$99.12
EV/Reserves ($/oz)	$208.31

Summary

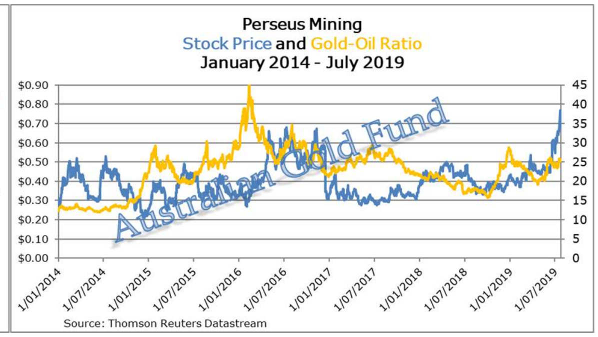
Perseus Mining released their June 2019 quarterly report on 18th July 2019. The company delivered for the quarter 64 125oz at AISC of around A$1 412/oz, and for the year 271 825oz at AISC of A$1 379/oz. Based on the initial guidance for 2019 of 260 000-300 000oz at A$1 250-$1 425/oz (converted from USD), the company delivered at the lower end of the production range and at the upper end of the cost range. The company did narrow down the range to 271 000-291 000oz at A$1 295-$1 400/oz in the first half of the year. Either way, the company managed to meet their guidance range but at the lower end after a somewhat challenging year with the gold price starting the financial year in weak territory and improving from February onwards and the oil price at times rising to over US$60/bbl.

Over the fourth quarter, the Edikan mine delivered 42 555oz at AISC of A$1 557/oz while the Sissingue mine delivered 21 570oz at AISC of A$1 130/oz, taking the annual performance to 191 971oz at AISC of A$1 465/oz for Edikan and 79 853oz at AISC of $1 045/oz for Sissingue. Performance at the Edikan mine has been falling over the year, although the 2019 overall performance in the context of the mine's history appears to be in the upper end of the range. The mine is recognised to be low grade and medium to high cost. As for Sissingue, production is ramping up at an annual rate of just above 80 000oz, with cost being relatively low given that the company has been processing higher grade ore relative to the mined ore. Time will tell whether the company will be able to continue with this in the future.

The net cash position for Perseus increased by over $70m as a result of operating cashflows generated from the two mines as well as around $54m generated from the exercise of warrants from the Amara acquisition at $0.44. $19m of debt was repaid over the quarter as well. The operating margin for Edikan was $12.2m (A$297/oz) and $15.3m from Sissingue (A$790/oz). Going forward on these two mines, the Edikan mine is expected to continue with its current trajectory of production being at this level with costs being in the A$1 400-$1 500/oz zone as the Esuajah North pit is unpredictable. However, the processing plant is expected to continue to result in improved recovery rates. As for the Sissingue mine, management indicates that access to higher grade ore is expected in the September quarter despite volume being less. The mine is even expected to deliver higher production than what was initially predicted in the life of mine plan.

Regarding the Yaoure project, the company has secured the mine development funding plan as well as engaging Lycopodium on 8th May 2019 to engage in the construction. The company expects the first gold pouring to be in early 2021, with the end of 2020 as the stretch target. The mine cost is expected to be US$265m (A$380m) and will produce around 215 000oz p.a. for 8.5 years. Developing the mine will be funded by existing cash and bullion plus a US$150m credit facility as well as operating cashflows from the existing mines. Should everything go according to plan for the company, by 2021, the company will be producing gold at around 400 000oz p.a.

In light of the Federal Reserve changing direction with the monetary policy and thus signalling the weakness and uncertainty surrounding the global financial system, the gold price has risen to over US$1 400/oz and A$2 000/oz. Investors have a renewed interest in gold mining companies, which justifies a re-rating of the industry in general. Taking into account also that Perseus Mining has delivered and met guidance, albeit marginally, we revalue the company upwards from the previous report. The lower end has been upgraded substantially after considering the company's financial position is solid. We have not increased the upper end of the guidance range given that Edikan has been underperforming and the company is entering into development phase with Yaoure that will put some pressure on the financial position. At the current price of $0.73, the company is still undervalued despite the stock price rising around 65% over the quarter.



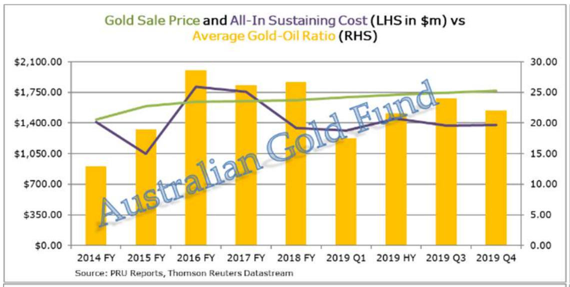
Prevailing Environment

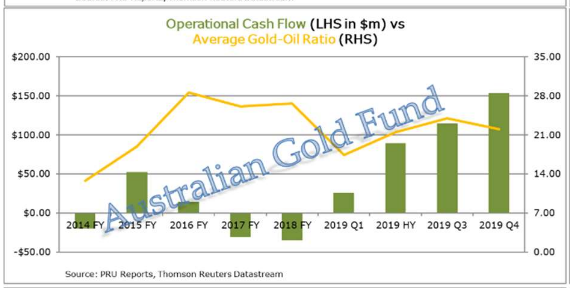
The first half of 2019 has seen the global financial markets make some recovery after a rather sharp decline in December 2018 as the Federal Reserve continued with their monetary policy of raising rates despite the real economy being weak, in conflict with the official economic and unemployment data. The tone of the Federal Reserve began to change as 2019 took its course. Should the Federal Reserve reduce interest rates in July, this would indicate the end of the rates cycle that began in the end of 2015 when the Federal Reserve began to raise interest rates from an unprecedented rock-bottom level of 0.125% and peaked at 2.375%.

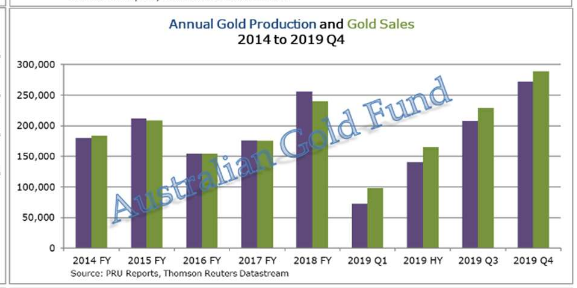
The change in the tone of the Federal Reserve is in conjunction with other central banks around the world taking a more dovish stance. The Reserve Bank of Australia surprised the market with a 0.25% reduction in early June 2019, taking it to 1.25%. This rate reduction comes as a result of a surprise return of the Coalition government in the 18th May election on the backdrop of promises by the government to try to boost a weakening jobs market and slow down an accelerating decline in the property markets in the eastern seaboard.

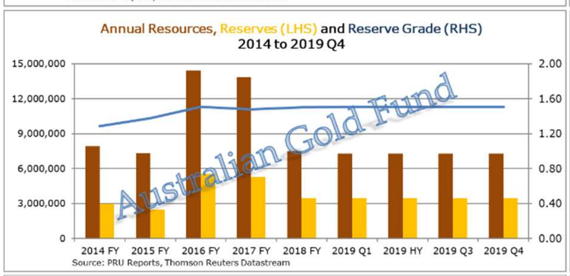
The gold price for most of early 2019 was rangebound between US$1 260-$1 350/oz, but this took a sudden turn after the June meeting on 19th June 2019 when the Federal Reserve indicated they were looking to start reducing rates as early as the July meeting scheduled on 30th-31st July. The gold price rose above US$1 400/oz on 24th June 2019, for the first time since 2013 after the sharp decline in April and June. At the same time, the gold price in Australian dollar terms went above $2 000/oz and supported further by a weaker Australian dollar. The oil price has been trading between US$50-$65/bbl on the backdrop of rising Middle East tension with Iran being in the spotlight. The US-Iran tension in the Persian Gulf and Strait of Hormuz is attracting much media attention and serves to keep the oil price hovering around the US$60/bbl mark. Fortunately, this does not give too much headwinds to the gold mining companies, given the gold price has been strong and is expected to stay this way with more accommodative central bank monetary policy and increasing public awareness of the fragility of the current petrodollar system.

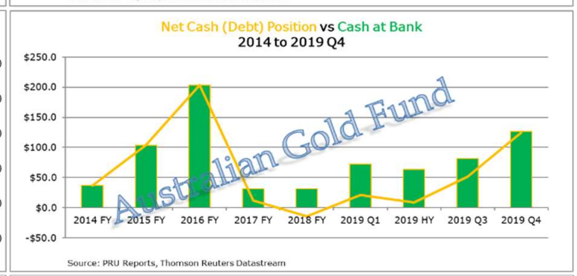
Operational and Financial Performance Charts

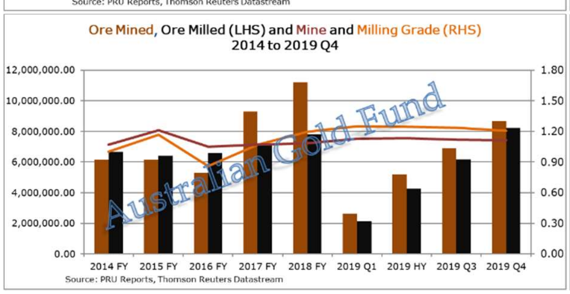


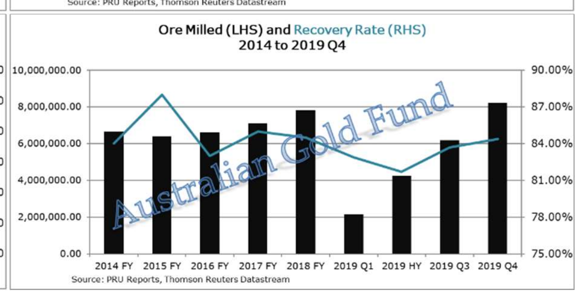








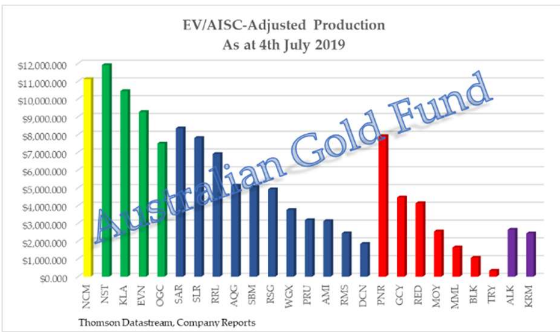


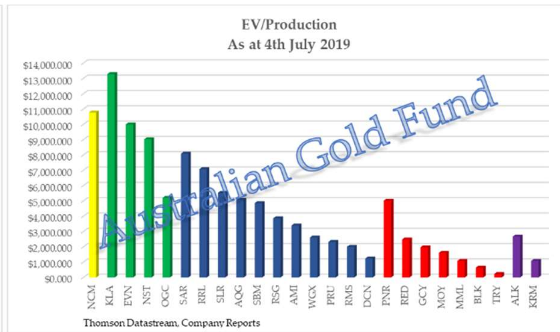


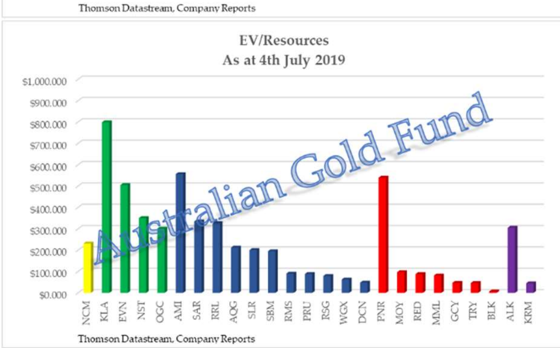
SWOT Analysis

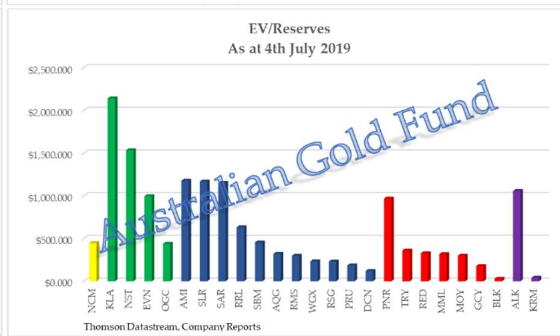
Strengths	**Weaknesses**
• Growth potential arising from the Yaoure mine development that will propel the company to become a 400 000oz p.a. producer. • Solid financial position with ability to generate operating cashflows from existing mines. • Mine life for Edikan and Yaoure underpin at least 10 years of production.	• Low ore grade in the flagship Edikan mine keeping AISC at relatively high levels. • Mines are operating in West Africa, a region known to be politically unstable.
Opportunities	**Threats**
• Underground mine development opportunities in Edikan and Sissingue when the open-pit mines are in run-off. • Sissingue mine expansion looks encouraging given current operating performance.	• Islamic militants moving southward from North Africa can pose threats to West Africa, leading to potential operational delays or even mine seizures.

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.

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