Australian Gold Fund Valuation and SWOT Analysis

Stock Valuation Report

Red 5 Limited (ASX: RED)

Date	3/05/2019
Classification	Junior Gold Miner
Current Price	$0.110
No. Issued Stocks (m)	1243.2
Net Cash + Bullion + 0.5 x GIC ($ m)	$5.45
Last Dividend Payment ($ p.a.)	$0.00
Market Capitalisation ($ m)	$142.96
Enterprise Value ($ m)	$137.51

Ranking	**Overvalued**
Price Range	$0.052-$0.115
Annual Production Guidance (oz p.a.)	98 000-103 000oz
All-In Sustaining Cost Guidance ($/oz)	$1 500-$1 650
EV/AISC-Adjusted Production Guidance ($/oz)	$2,058.00
EV/AISC-Adjusted Production Range ($/oz)	$1 000-$2 000
Resources (oz)	2,708,000
Reserves (oz)	725,750

Summary

Red 5 has cemented itself as a junior mining company with significant growth opportunities that are in the development phase. The company reported a weak Q3 performance, delivering 24 187oz at AISC of $1 637/oz, which is in the lower range of the projected guidance of 24 000-28 000oz at AISC of $1 450-$1 650/oz. The previous quarter showed a production of 26 118oz at AISC of $1 547/oz, also at the lower end of their projected guidance. Operating cashflows excluding capital expenditure are slightly positive at $5.05m, which is encouraging. The cash and bullion account continued to decline, although by less than $1m to $13.514m. Red 5 is still in a net cash position of $4.2m, down from $5.4m last quarter. During the quarter, the company announced encouraging drilling results from exploration of the King of the Hills underground mine, with certain intercepts registering more than 100g tonnes of gold ore. The King of the Hills operations continued to ramp up their operations with slightly increased ore being trucked to the Darlot processing plant, and is expected to increase further for the June quarter. The mine has not reached commercial production status yet, and no indication has been given as to when this will occur.

The March quarter performance was at the lower end of the guidance provided in the previous quarter arising from 10% reduction in volume of tonnage processed (201t vs 228.3t in the previous quarter), offset by a 5% increase in the head grade processed (4.06g/t vs 3.87g/t in the previous quarter). This reduction in processing volume came about from a planned shutdown as a gravity concentrator was installed in February, which is expected to improve recovery rates. Production costs remained stubbornly high, but this is partly driven by weaker volume. This is expected to decrease as a result of more tonnage being mined and transported from both the Darlot and King of the Hills operations, the latter which is expected to eventually contribute to 50 000t per month, up from 36 000t per month over the March quarter. The King of the Hills operations are also expected to feed the processing plants with superior gold grades of 4.5g/t or higher.

The company has continued to deliver excellent exploration results from their King of the Hills underground mine. The resources for this mine are now measured at 1.88Moz, with reserves to be updated in the coming quarter. Mining methologies are expected to improve grade recovery Such is the positive outlook on the mine that the company is reviewing plans to construct a 2.4Mt p.a. processing plant and make this mine a standalone operation. Outside of Australia, the Philippines operations continue to be on hold. The Siana open-pit and underground operations are being developed with a view to submission to the government for approval to recommence production after the mine was put into suspension in April 2017.

Red 5 continues to deliver more encouraging exploration results and the development progress at the King of the Hills operations is considered to be positive. Investors may consider the low cash reserves and marginal net cash position to be a dampener on their growth opportunities coming to fruition

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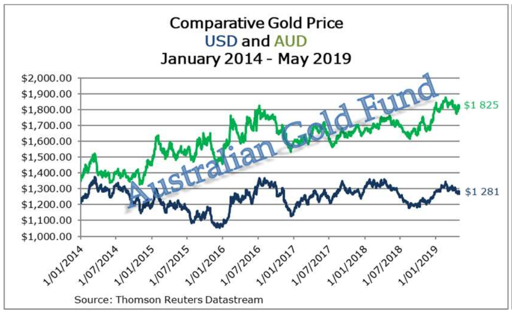
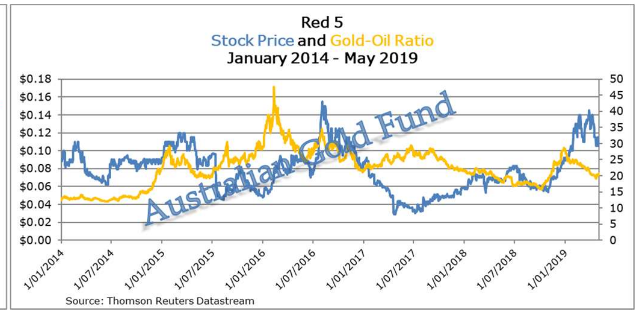
without further funding either from an equity raising or bank loans. Operating performance is gaining momentum, albeit slowly but in the right direction. The valuation range is upgraded to reflect the progress in their development phase and also recognising their ability to generate positive operating cash flows despite the difficulties faced. However, despite the upgrade, the stock price has moved strongly upwards since December 2018 and is now at an overvalued level. Investors may be moving ahead of themselves, anticipating Red 5 to have reached their next phase of operations.



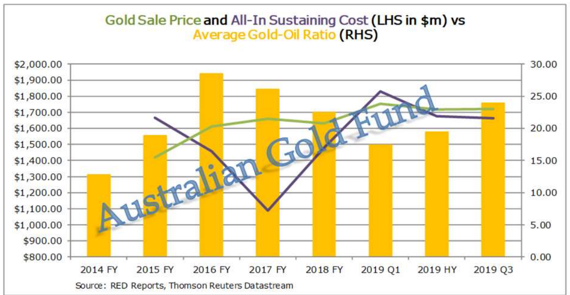


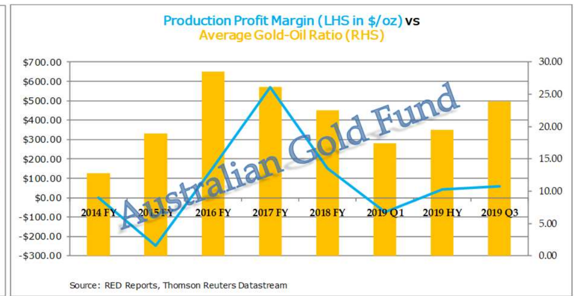
Prevailing Environment

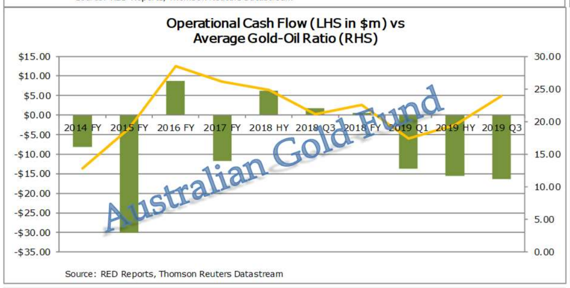
The March quarter has been a challenging one for many gold mining companies despite the gold price trading in the US$1 280-1 345/oz and A$1 790-1 880/oz range. Part of this is caused by the oil price rising 33% from US$45/bbl to US$60/bbl during the quarter, leading to the gold to oil ratio placing some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

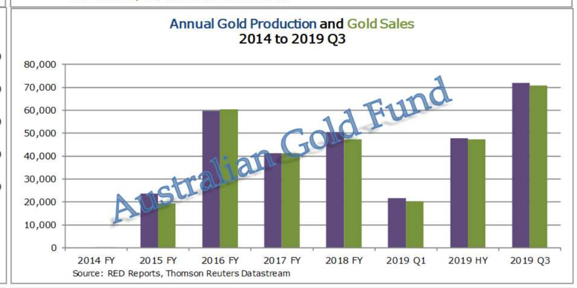
Since the end of the March quarter, the gold price has further weakened while the oil price has increased. The gold to oil ratio has fallen to the 20-21 mark, but there are signs that the gold price is nearing a bottom while the oil price is falling. The months of April and May tend to be cyclical bear 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.

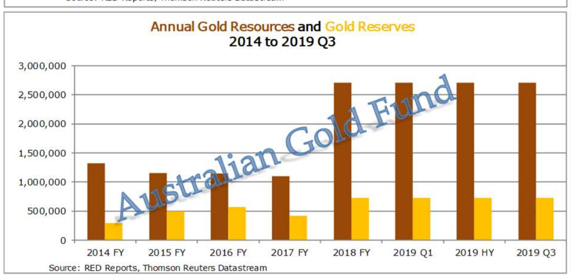
Operational and Financial Performance Charts

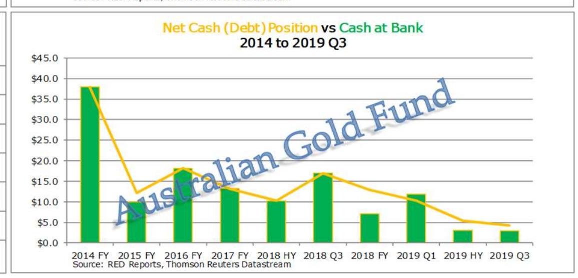








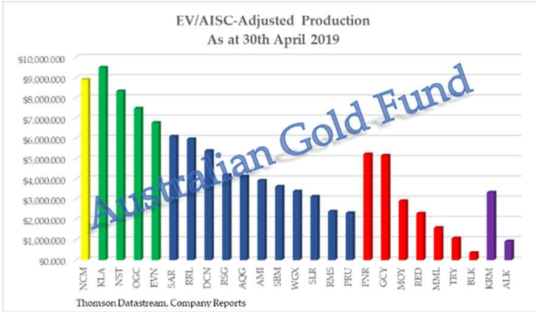


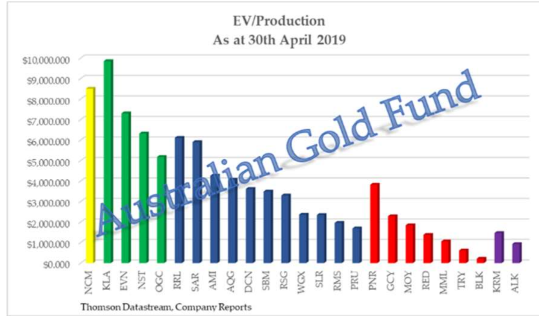


SWOT Analysis

Strengths	**Weaknesses**
• On track to become a junior mining company producing over 100koz p.a. with two operating mines within the next 12 months. • Development projects are beginning to deliver higher production at reduced costs, leading to substantial cashflow generation.	• Low cash reserves and limited liquidity may stifle growth and development as well as being able to manage hostile conditions.
Opportunities	**Threats**
• The King of the Hills mine exploration results are showing signs of a major mining operation. • As the bottlenecks in the Darlot processing plant are behind the company, increased ore processing will deliver higher production and greater cash flows.	• Further delays in operations or blowouts in development costs may threaten its cash position. • With significant growth potential but weak liquidity position, the company may be a takeover target of cashed up mid-tier and major mining companies seeking cheap ounces to add to their portfolio.

Peer Comparison





Glossary

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.

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 measure 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 **EV/AISC-Adjusted Production Range** 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.

Disclaimer

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