Australian Gold Fund Valuation and SWOT Analysis

Ramelius Resources Limited (ASX: RMS)
2020 Outlook and Life of Mine Plan for Mount Magnet, Vivien, Edna May, Marda and Tampia

Date	24/06/2019
Classification	Mid-Tier Gold Miner
Current Price	$0.750
No. Issued Stocks (m)	657.9
Net Cash + Bullion + 0.5 x GIC ($ m)	$104.70
Last Dividend Payment ($ p.a.)	$0.00
Market Capitalisation ($ m)	$493.40
Enterprise Value ($ m)	$388.70
Resources (oz)	4,138,000
Reserves (oz)	987,000

Ranking	**Very Undervalued**
Price Range	$0.73-$1.135
2020 *Est* Annual Gold Production Guidance (oz p.a.)	200 000-225 000
2020 *Est* All-In Sustaining Cost Guidance ($/oz)	$1 225-$1 325
EV/AISC-Adjusted Production Guidance ($/oz)	$2,332.00
EV/AISC-Adjusted Production Range ($/oz)	$2 500-$3 500
EV/Resources ($/oz)	$93.93
EV/Reserves ($/oz)	$393.82

* Estimates are discretionary to include some personal judgment by the autho

Summary
Ramelius Resources released last Monday a Life of Mine plan for their mine operations, including an update on the Marda and Tampia mine projects that they have acquired last year. The report provided more clarity over their production and exploration profile for the next five years. The company has also provided updates on the resources and reserves for the Marda and Tampia projects. Investors initially reacted negatively on this report, selling the stocks such that the price declined as much as around 33% from its peak of $0.95 earlier this month to $0.645.

The company's Life of Mine plan expects production over the next five years from their various mine properties to be around 1 084 500oz with an AISC of $1 220-$1 320/oz. This assumes production from their current development plans including Mount Magnet (open-cut and underground), Vivien (underground), Edna May (open-cut and underground), Marda (open-cut) and Tampia (open-cut), but excludes long-term expansion plans for their mine properties. The diagrams on p.2-p.4 of the Life of Mine Plan report show the schedules milling at Mount Magnet and Edna May. Peak production is expected to be in FY2022 and FY2023. A large portion of the production appears to be coming from open-cut mines, implying that there may be potential for exploration campaigns in future to develop underground deposits, which hold higher grades.

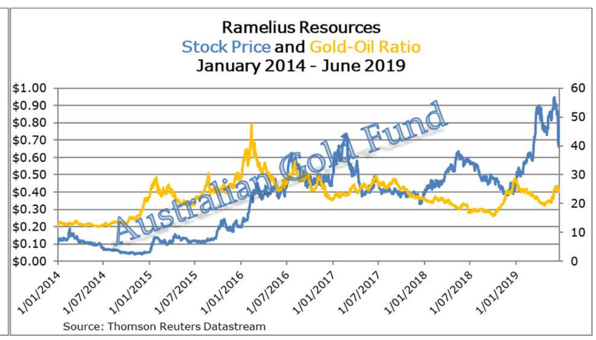
The company has chosen to use the trucking option to transport the Marda and Tampia ore to the Edna May mill, which will take around 3 hours travelling distance. The option to truck the ore from Tampia to Edna May instead of building a mill on-site is based on the projection of building a mill would cost $118.5m and deliver an NPV of $24m while hauling the ore to the Edna May plant would cost $50m and deliver an NPV of $67m. The resultant amount of ore delivered from Tampia to Edna May is expected to be 257 000oz over 3-5 years, notwithstanding further exploration with production commencing in 2021. The Marda project is expected to commence producing in 2020 and will provide a modest addition to the annual production over the next five years, with the highest production in 2021 of around 50 000oz.

Among a few factors that may have contributed to a sharply negative reaction by investors after the release of this plan is the updated resources and reserves estimates of Marda and Tampia. When the company acquired Explaurum and hence the Tampia mine, the resources and reserves were estimated to be 695 000oz and 485 000oz, respectively. However, management has become more conservative with the mineral estimates, as the grade has increased from 2.1g/t to 2.8g/t. Similarly, the Marda mine was purchased with estimates of 333 525oz resources and 150 900oz reserves at 2.3g/t and the company has revised them downwards to 300 000oz and 89 000oz at 2.4g/t, respectively. Management has highlighted their conservative stance on their plans going forward.

To place the management's track record in acquiring mines and delivering production, it is worth noting that the Vivien gold mine was acquired for $19.5m in October 2013 and the Kathleen Valley gold mine for $4.1m in June 2014. The Vivien gold mine recorded resources and reserves of 184 000oz and 101 000oz, respectively. To date, the company has delivered 139 252oz and is expected to deliver another 50 000oz up to 2020. The Kathleen Valley gold mine recorded resources and reserves of 163 000oz and 55 000oz, respectively while the mine delivered 65 244oz over the 2016 and 2017 financial years. At the time the project was sold to Lion Town last year, the project still had 66 000oz of resources.

With the Life of Mine plan delivered to the public, the company has provided greater clarity on the outlook of the company. While the production and exploration summaries appear somewhat disappointing, the company's past track record should provide some context for a more pragmatic perspective. Noting also that the AISC range estimates will average $1 220-$1 320/oz and the capital expenditure will be around $230-280m over the next five years, the company looks to be able to build their cash balance for dividends and further acquisitions. Management has indicated that the dividend policy will be reviewed as to whether the company will pay a dividend for the 2019 end of financial year.

Based on the current stock price of $0.75 and the gold price rising to over A$2 000/oz, Ramelius Resources looks to be undervalued based on the current production and cost levels. Despite the reserves level falling slightly below 1Moz, though this is yet to be confirmed, the EV/Resources and EV/Reserves are also attractive. Given that the Federal Reserve is signalling a more dovish stance, gold price rallies may continue and offer tailwinds for Ramelius Resources.

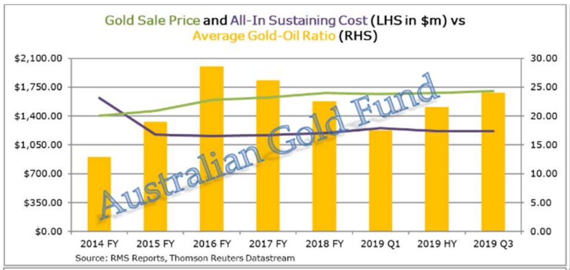


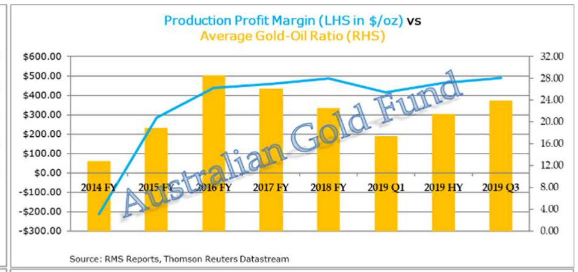
Prevailing Environment

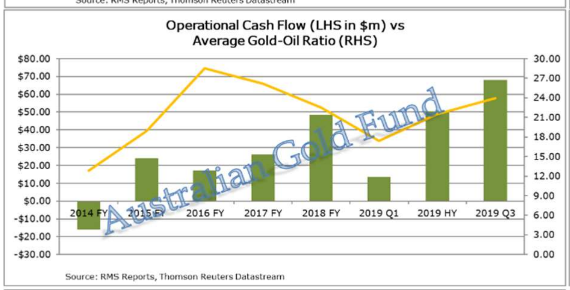
The March quarter has been a challenging one for many gold mining companies despite the gold price trading in the US$1 280-1 345/oz and A$1 790-1 880/oz range. Part of this is caused by the oil price rising 33% from US$45/bbl to US$60/bbl during the quarter, leading to the gold to oil ratio placing some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

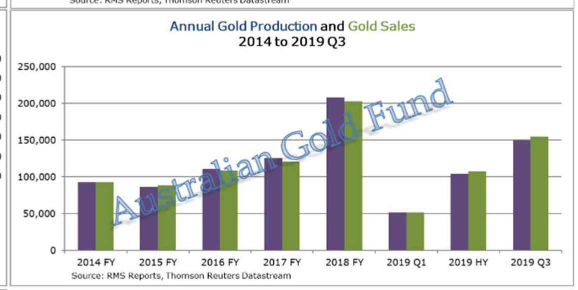
Since the end of the March quarter, the gold price weakened to below US$1 300/oz while oil held above US$60/bbl until late May when the US Federal Reserve had a change in tone regarding interest rate rises going forward. Some central banks have indicated rate cuts may occur in the future. Furthermore, the oil price weakened sharply as the US Department of Energy revealed that their crude oil inventory has increased. By mid-June, the gold price has risen to the US$1 330-$1 350/oz range, while breaking the all-time records for the Australian dollar. With oil price in the low 50's, this is an excellent backdrop for gold and other resources companies to operate. As foreshadowed in reports last month, the June to July period usually is one where fortunes turn for mining companies. 2019 appears to be no exception.

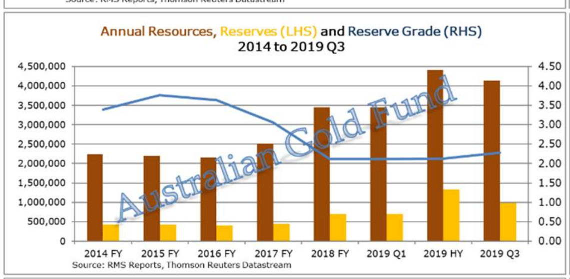
Operational and Financial Performance Charts

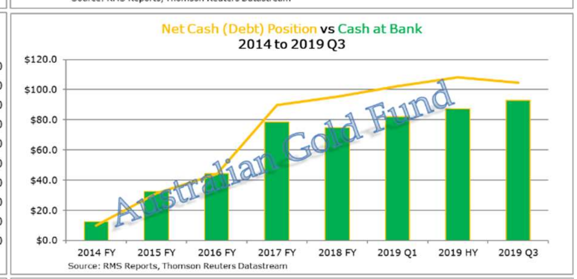


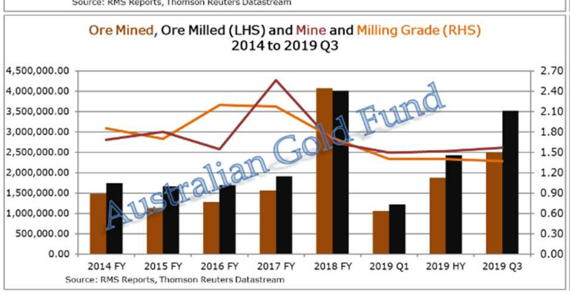


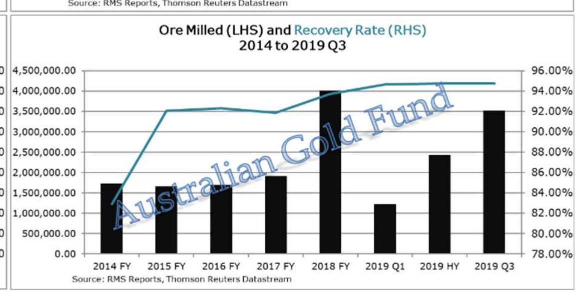










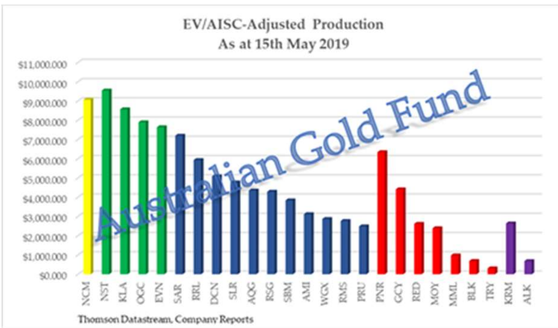


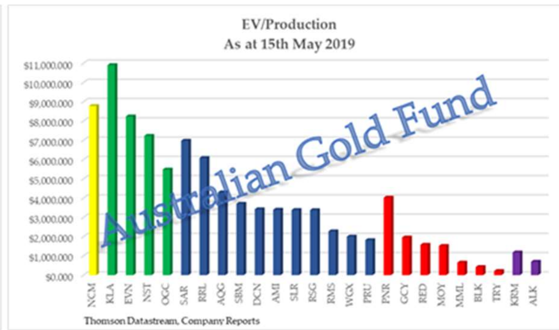
SWOT Analysis

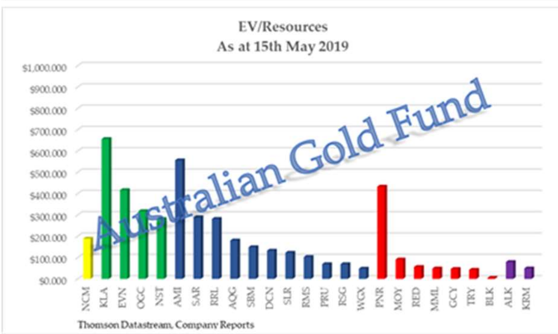
Strengths	**Weaknesses**
• Solid production profile for the next five years, with potential to expand. • Cash balance is adequate to fund current plans, future acquisitions and dividend payments.	• Delays in the Greenfinch deposit development and Edna May underground production have been frustrating for investors. • Reserve life is just under 5 years.
Opportunities	**Threats**
• As the gold price is rising, many exploration companies are cash-strapped and may be suitable acquisition targets.	• Significant capital expenditure in 2020-2021 may lead to blowouts if they do not deliver results.

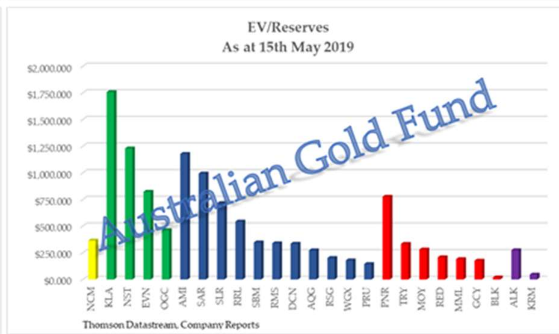
• Mount Magnet and Edna May still have substantial underground deposits that may be explored in future, along with Marda and Tampia.	• As open-cut deposits start to deplete, the cost and risks associated with going underground will expose the company to more volatile outcomes.

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

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