Australian Gold Fund Valuation and SWOT Analysis
Ramelius Resources Limited (ASX: RMS)

Date	13/05/2020
Classification	Mid-Tier Gold Miner
Current Price	$1.380
No. Issued Stocks (m)	789.2
Net Cash + Bullion + 0.5 x GIC ($ m)	$106.55
Last Dividend Payment ($ p.a.)	$0.01
Market Capitalisation ($ m)	$1,089.12
Enterprise Value ($ m)	$982.57

Operating Performance Metrics	
Annual Gold Production Guidance *2021 Estimate* (oz p.a.)	235 000-250 000
All-In Sustaining Cost Guidance *2020 Estimate* ($/oz)	$1 150-$1 250
Operating Margin (Sale Price less AISC)	$637.02
Resources (oz) (Incl. Penny West)	4,537,000
Reserves (oz)	876,000
Financial Year Cumulative Production (oz)	143,909
Production as % of Annual Guidance	66.93%
Financial Year Cumulative AISC ($/oz)	$1,242.70

Valuation Metrics	
Price Range	$1.21-$1.925
Overall Ranking	Undervalued with MT Growth
Current EV/AISC-Adjusted Production	$4,862.00
EV/AISC-Adjusted Production Range	$4 500-$6 500
Ranking	Undervalued
EV/Resources	$216.57
Ranking	Fair Value
EV/Reserves	$1,121.66
Ranking	Overvalued

Summary
Ramelius Resources released their March quarterly results and an updated Life of Mine plan on 30th April. The company is in the process of completing the acquisition of Spectrum Metals (ASX: SPX), acquiring over 90% of the company's stocks since 7th May 2020. Going forward, they are expecting to substantially increase their production profile given that their exploration campaigns have led to successful additions to their Eridanus deposit and their Edna May mine as well as the government approval for commencing activity in their Greenfinch deposit. The last 18 months have seen Ramelius Resources transform substantially and we are at the stage to witness the harvesting stage.

For the March quarter, Ramelius Resources produced 51 825oz at AISC of $1 248/oz. This compared favourably to the previous two quarters where production were around 44 000oz and 48 000oz, respectively at similar costs. The Mount Magnet operations produced 38 981oz at a rather commendable AISC of $1 114/oz while Edna May operations (including ore feed from the Marda deposit) yielded 12 844oz at AISC of $1 618/oz. The company increased their cash and bullion on hand by $2.6m from their operations, although they drew down $32.5m in borrowings for liquidity purposes in light of the coronavirus and economic slowdown that ensued. The cash balance increase was modest as capital expenditure during the quarter amounted to $21.5m, with almost 50% of it in developing the Marda deposit that began to produce ore. Thus, the operating cashflow performance is commendable.

For the Mount Magnet operations, production is expected to increase in the coming quarters with mining activities being focused more on the Eridanus deposit as well as underground ore from Hill 60 and Shannon. Open-pit mining during this quarter almost doubled that of its historical trend, showing a new phase for this long-standing mine. At the same time, the high-grade Vivien mine is running off with lower grade ore being extracted. This mine has served Ramelius Resources exceptionally well since they acquired it in late 2013 for around $20m, having delivered over 175 000oz of gold for the company. At the same time, their acquisition of Spectrum Metals means the very high-grade Penny West deposit will take the place of the Vivien mine by the time it is depleted in mid-2021.

For the Edna May operations, production has continued to be relatively slow as the underground operations begin to ramp up and ore is being fed from Marda. As foreshadowed in the 2019 Life of Mine plan released in mid-June, the company expected that the mill throughput would decrease from

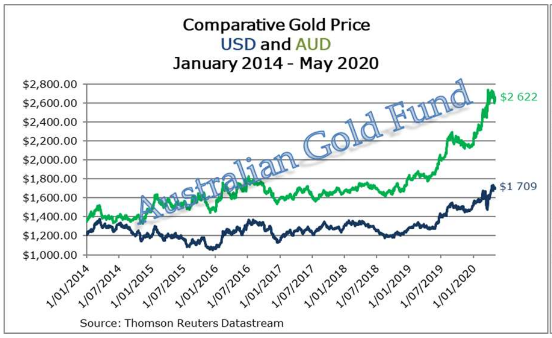
2.7Mt p.a. to 2.0Mt p.a. due to the need to accommodate for finer but higher grade ore feed from their underground mine as well as those from Marda and Tampia. The Edna May underground mine has ramped up further producing over 40kt of ore at 5.89g/t, almost double the amount extracted for the first half of the year. The observed trends with the mined ore grade and volume are encouraging. Based on last year's Life of Mine plan, the Edna May underground mine is expected to 40 000-55 000oz p.a. till 2023 and this could be revised upwards in the upcoming Life of Mine plan when the company has completed the review of the Tampia mine production schedule. The Marda ore is being fed to the processing plant and is expected to be produce a moderate amount of gold, between 15 000-25 000oz p.a. from 2020-2024, though in 2021 it will be around 50 000oz. Regarding Tampia, management has some encouraging news as the upfront capital required has fallen to $26.4m from $50m. The expected production of gold over the life of the mine increased around 7% to 174 000oz to 186 000oz with a slight decline in the ore grade. The increase in the gold price has allowed for more marginal ore to be classified as being economic to mine, thus more gold expected to be produced. Further gold price increase could see this increase further. The commencement of operations at Tampia will be pushed to early 2021, although the company does not expect this to reduce production given the ramping up of Mount Magnet and also the improvement in the Edna May underground operations.

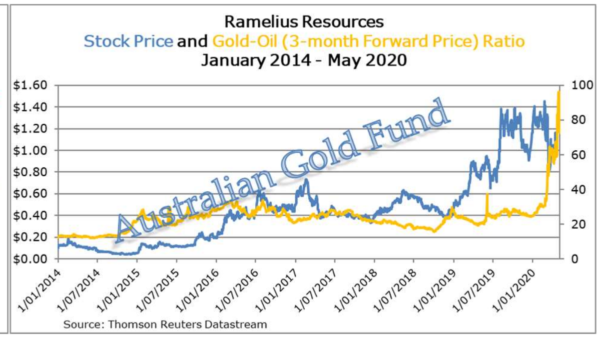
While Ramelius Resources currently has reported their Ore Reserves to be less than 1Moz, we note that the Edna May and Tampia reserves were all adjusted downwards in 2018 and 2019, leading to the stock price decline. However, given the substantial rise in the gold price in the recent year, they will likely see these reserves making a reappearance as their substantial Mineral Resources that exceeds 4.5Moz are upgraded. The company's mine life as understood by the market is very conservative. With the observed trend in the ramping up of operations across their properties, we are confident that they will organically grow with the 2021 production having been upgraded from 235 500oz to 250 000oz. This could increase with the addition of the Penny West deposit, if they are able to commence extracting ore from that deposit and process it at Mount Magnet.

Going forward, the June quarter appears to provide a good indicator of what may possibly be the next phase of Ramelius Resources' trend in operations. Production is expected to be 65 000-70 000oz at a substantially lower AISC of $1 000-$1 100/oz. The capital expenditure spend is expected to be further reduced at $12.3m so this could see the company's cash reserves rise strongly. Even though the company has 263 650oz hedged from June 2020 to December 2022 (approximately 33% of production) at an average price of A$2 102/oz, they are still exposed to the rising spot gold price. The June 2020 quarter should be quite encouraging as they have only 15 800oz at A$2 000/oz and with higher production expected, this will see a jump in the cash balance. The September and December 2020 quarters see approximately 50% of production being hedged and this may appear to be a speed bump on their cashflow generation.

At the current stock price of $1.38, the market capitalisation is $1.09 billion and the enterprise value is $983m. The implied EV/AISC-Adjusted Production on the 2020 production guidance (210 000-220 000oz at AISC $1 150-$1 250/oz) would be around $5 500/oz that would place the company as being fairly valued. However, if we use the 2021 production guidance at 2020 cost levels (235 500-250 000oz at AISC $1 150-$1 250/oz), this will give an EV/AISC-Adjusted Production of $4 862/oz, which puts it to being undervalued. The company's operating margin (gold sale price less AISC) is $637/oz while the EV/Reserves is $1 122/oz and EV/Resources at $217/oz. The company's reserves is rather low though has a potential to be upgraded while the resources are substantial. Given the company's operational efficiency in processing the ore but the disparate conclusion on the valuation of their reserves and resources, we consider the valuation based on the long-term potential to be fair. We use the fair valuation range with the EV/AISC-Adjusted Production multiple range of $4 500-$6 500/oz given their current production level, reserves and resources place them in the upper mid-range of their peers. We believe the fair value range for this company to be $1.21-$1.925, with upward potential when their latest Life of Mine update is released before end of June.

Prevailing Environment



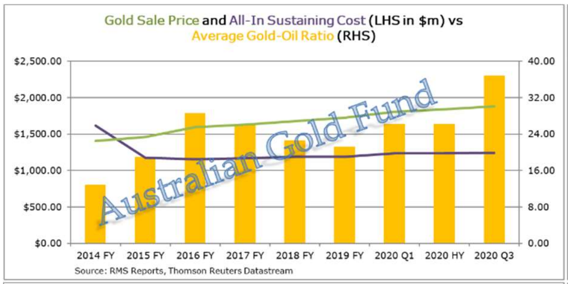


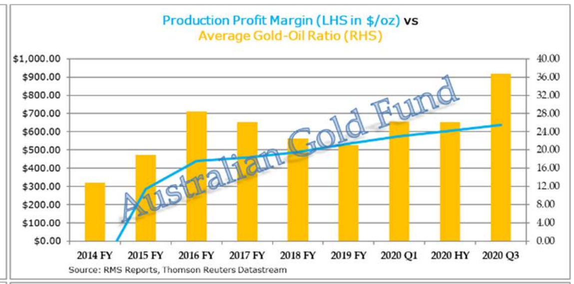
The recent four months have seen the world and the global financial markets face some monumental events that have made a lasting impact, and will expect to steer the world in a different trajectory hereafter. A combination of events starting with the US-Iranian conflict (who still remembered this?) in early January, the spreading of the coronavirus leading to a pandemic starting late last year, the collapse of OPEC talks in early March and then the sharp global market crash from late February to March have shaken nations, corporations and households alike. In the midst of this, most market indices around the world declined 25-40%, most commodity prices fell (except for gold) and so did cryptocurrencies (though some have bounced to back and more). The Federal Reserve cut their interest rate to 0-0.25% by mid-March, bringing them back to late-2008 at the onset of the subprime crisis. In addition, the Federal Reserve Board of Governors has indicated that they will have almost unlimited capacity to create currency to monetise debt in the bid to prevent the economies and markets from imploding. Other central banks have followed while the Reserve Bank of Australia has cut rates to 0.25%. Governments have announced stimulus packages and foreshadowing tax cuts to aid small businesses and households facing national lockdowns that have brought many cities to a standstill.

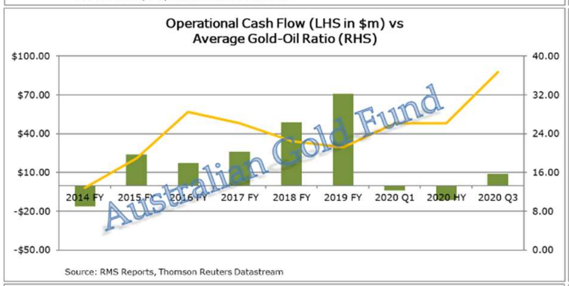
In the midst of all this, the gold price has seen a steady rise during this period with a short yet violent decline for a few days in March when it went below US$1 500/oz. However, gold demonstrated its safe haven status, laying claim to being one of very few assets that saw its price stand strong during the market-wide sell-off. The gold price started the year at US$1 520/oz and traded during this period in the US$1 460-$1 750/oz range. In Australian dollar terms, gold has broken out on the upside, starting the year at A$2 163/oz and peaking at over A$2 800/oz as the Australian dollar dipped to as low as US$0.56.

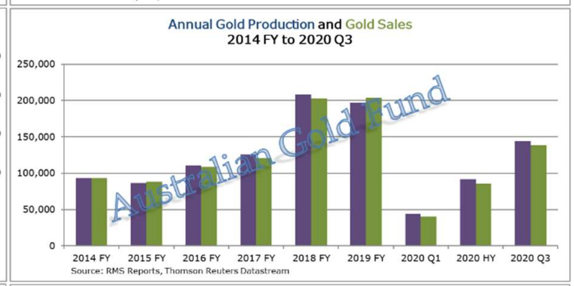
The oil price has also seen a historic crash from US$64/bbl in early January in the wake of the drone strike by the US that killed the Iranian Revolutionary Guard Commander Qassim Soleimani to US$16.60/bbl in late March in the aftermath of OPEC facing potential breakdown after negotiations between Saudi Arabia and Russia on production targets failed on 6th March. However, the spot price for WTI crude oil went outdid its decline and fell to -$37.63/bbl on 20th April, an unprecedented and inconceivable event (imagine at one stage a pack of toilet paper is cheaper than a barrel of oil, go figure!). The gold-oil ratio exceeded 100 and is currently at 60-70 range. With many countries beginning to relax their lockdown restrictions from this point on, we expect economic recovery to be gradual but demand will likely to be slow for some time. This could lead to the demand for oil to continue to be tepid and the oil price to remain low. This should provide substantial tailwinds for mining companies and industries that are still running given input costs should be lower for a short while.

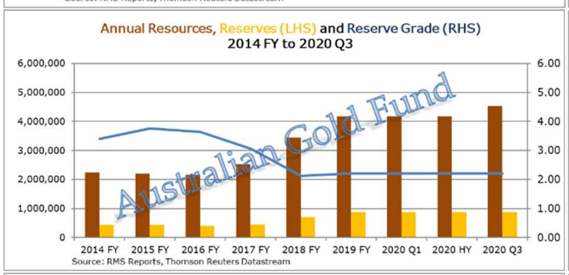
Operational and Financial Performance Charts

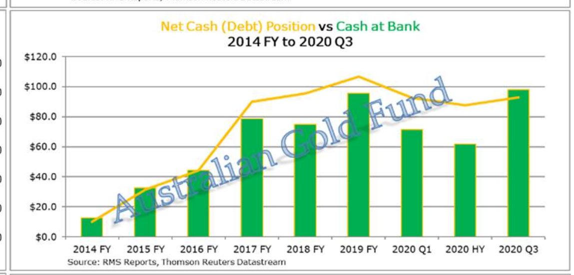


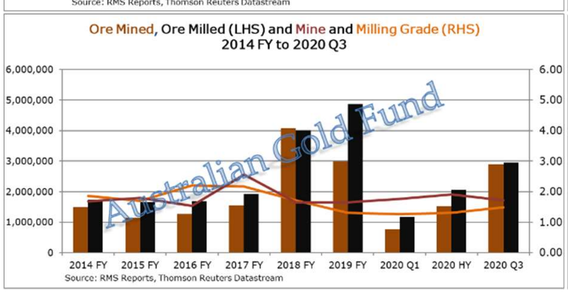


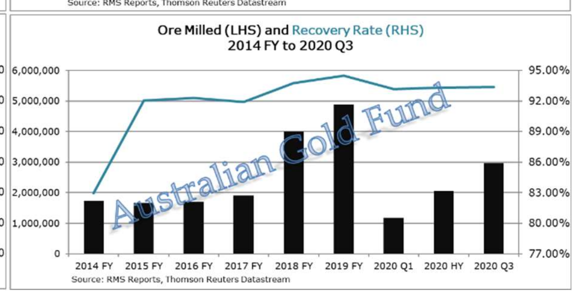








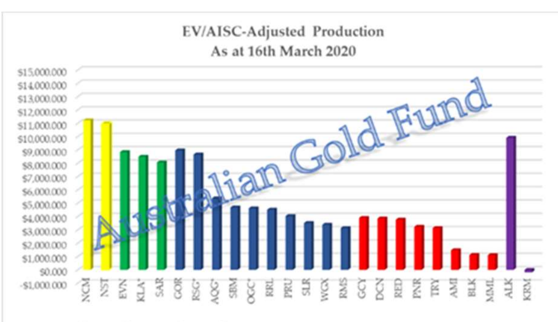


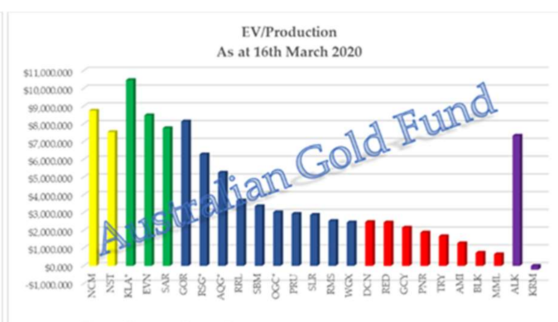


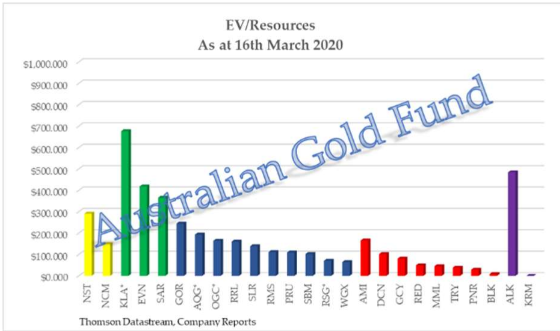
SWOT Analysis

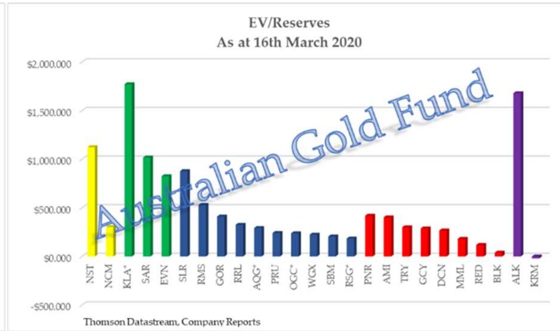
Strengths	Weaknesses
• Entering into transformation phase where their previous capital investments will yield higher production and lower costs. • Management shows prudence and insight into making timely acquisitions and developing projects into producing mines.	• Currently reported Ore Reserves appear to show limited mine life and thus dampened investor sentiment, though this is expected to change. • Management appears to make acquisitions on smaller mines rather than being more ambitious. • Two processing plants with several small-scale satellite deposits can be economically inefficient.
Opportunities	**Threats**
• Further bolt-on acquisitions of nearby mine deposits could further lead to increases in production as well as increased reserves to extend mine life. • Sufficient cash reserves to potentially increase existing processing plants should their reserves increase to allow for higher production without reducing mine life. • Significant potential to see reserves upgraded as a result of higher gold price.	• Any further downgrades of reserves due to errors in geological modelling could threaten investor confidence due to their mine life. • Geographic concentration in Western Australia may mean they are vulnerable to any legislative changes made by the state that could be detrimental to their operations (especially in light of recent restrictions made around the world by governments over the coronavirus pandemic).

Peer Comparison









Valuation Thesis

Our key valuation metric is the **EV/AISC-Adjusted Annual Production** as we have found in our empirical study that the market valuation is most aligned to this metric, as opposed to earnings, resources and reserves. We also prefer a multiples method over the typical Discounted Cashflow Method for valuation because we understand that beyond even one year of projection, everything is highly speculative – whether it is the management outlook on production and costs as well as the gold price and broader economic drivers. To allow for comparison across all classes of producers, our metric can standardise by the company's scope of production as we observe that the market values the companies with higher production with a greater multiple. However, we scale production by AISC because we believe that not all ounces are equal. Companies that can produce gold at lower cost are naturally more profitable and deserve a higher multiple of their production and other operational or financial performance measures. We use the following classes for the different tiers of gold producing companies – **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 **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). This metric quantifies the market value of the company's assets deployed in the company's operations. The **AISC-Adjusted Annual Production** calculated as the annual production of gold per oz divided by the AISC adjusted by a factor of 1 000. The factor of 1 000 is arbitrarily chosen as a way to standardise the final metric. As an illustration, if a company produces 250 000oz p.a. at AISC of $1 250, the AISC-adjusted production is 200 000.

When determining the production ranges in our valuation metric, we take the management guidance as this is based on their access to information relating to their operations and progress. We believe that the market will use the guidance figures to base their valuation and investment decisions. This may not always be optimal given that some management may have their bias in reporting their outlook, as well as having a track record of announcing surprises. In such cases, we seek to qualify this in our SWOT analysis and adjust it in our EV/AISC-Adjusted Production multiple.

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.

We recognise that many analysts consider discretionary forecasts and adjustments on the company's production level, ore grade, cost levels, resources and reserves and economic factors into their valuation. We have studied many of these reports and recognise their merits. However, our view is that such subjective adjustments are dubious in terms of additional accuracy of their estimations. This is because with mining companies, both internal and external drivers that affect the company's future performance are unpredictable. Furthermore, we understand that while a company with substantial resources and reserves have potential to convert into substantial value in future, this is contingent on the successes in building the infrastructure, extracting the ore from the ground and processing it in a cost-effective manner. We recognise the criticism by many regarding our approach, but we have tried and tested our valuation against the actual price performance as well as through our own investment performance. We let these results speak for themselves.

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-$12 000/oz*

Mid-Tier Companies *- $4 000-$7 000/oz*

Micro and Junior Companies *- $1 500-$4 000/oz*

Glossary

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 **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.

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.

Declaration of Interest

The Australian Gold Fund and its directors currently own Ramelius Resources stocks and may trade them subsequent to the report being published on their website. We do not receive any income or benefits from the company as a result of our report.