Australian Gold Fund Valuation and SWOT Analysis

Regis Resources Limited (ASX: RRL)

Date	12/02/2021
Classification	Mid-Tier Gold Miner
Current Price	$3.470
No. Issued Stocks (m)	512.0
Net Cash + Bullion + 0.5 x GIC ($ m)	$220.00
Last Dividend Payment ($ p.a.)	$0.16
Market Capitalisation ($ m)	$1,776.73
Enterprise Value ($ m)	$1,556.73

Operating Performance Metrics	
Annual Gold Production Guidance (oz p.a.)	355 000-380 000
All-In Sustaining Cost Guidance ($/oz)	$1 230-$1 300
Operating Margin (Sale Price less AISC)	$925.83
Resources (oz)	7,690,000
Reserves (oz)	3,620,000
Financial Year Cumulative Production (oz)	172,978
Production as % of 2020 Annual Guidance	47.07%
Financial Year Cumulative AISC ($/oz)	$1,391.71

Valuation Metrics	
Price Range	$4.43-$6.77
Overall Ranking	Undervalued
Current EV/AISC-Adjusted Production	$5,359.00
EV/AISC-Adjusted Production Range	$7 500-$10 500
Ranking	Very Undervalued
EV/Resources	$202.44
Ranking	Undervalued
EV/Reserves	$430.04
Ranking	Undervalued

Summary

Regis Resources is a well-established and respected low-cost mid-tier gold producing company with operations in the Duketon area in Central Western Australia as well as a major development project at the McPhillamys deposit in Central Western NSW. The company has been on a steady path but recently has indicated that they are on track to expanding their production by way of mine developments that are underway. This company is one of the most reliable and generous in paying dividends, having paid $488m in dividends since inception. Over the last three financial years, they have maintained a dividend payout of $0.16. At its current price and considering the context of the environment, the company stock is undervalued by all measures.

The company most recently produced 91 411oz for the quarter at AISC of $1 400/oz and ended the first half-year with production of 172 978oz at AISC of $1 392/oz. The higher cost is due to the Rosemont operations recording an AISC of $1 792/oz, largely arising from their underground development gaining traction. The second quarter's production is at the level comparable to 2019 when the company delivered record annual production. This year's annual guidance currently stands at 355 000-380 000oz at AISC $1 230-$1 300/oz, suggesting stronger production in the second half of the year, hopefully as the Rosemont underground mine gains momentum.

Having relatively steady operations while their peer companies have organically expanded or grew via mine acquisitions, Regis Resource now is beginning to undergo their growth stage through their newly completed underground operations in the Rosemont mine and the Garden Well underground mine development that will begin production in the 2021 December quarter. The Garden Well underground project is expected to produce 176 000oz at AISC of $950-$1 050/oz for around five years based on current reserves and resources. The cost of building the facilities for this operation will be $38m, with another $53-$58m for post-production expenditure. From the 2020 Q1 quarterly report, the transition to underground ore is expected to see the production lift to 400 000oz by 2022 with underground ore contributing

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to around 15%. The acquisition of the Ben Hur project last September has added 290 000oz to the company's resources with potential for a maiden reserve to be declared in the coming quarter. This project can serve as a satellite deposit to boost the mine life of Garden Well. Further to this, the much-anticipated McPhillamys project is pending approval by the state government in the first half of the year, with construction to begin as early as the second half of 2021 should things proceed favourably. This 2.02Moz reserve project may have a potential mine life of 10 years based on current metrics and deliver around 192 000oz p.a., bringing the company's annual production to exceed 600 000oz upon completion. Thus far, we understand that the company is awaiting the NSW Planning Department approval and further details on the project development finances and operating plan will come afterwards.

The company's financial position is robust with cash reserves at $220m and no debt, the cash balance falling by just under $5m after having paid $34.3m in cash dividends and $22.1m in income tax during the quarter. This implies the company had generated strong operating cashflows during the quarter once again. With several development projects coming up, they are positioned with ample headroom. One possible reason we can posit for the weaker stock price performance for RRL in recent times is that investors are anticipating a substantial cash spend for the upcoming development phase, that may either reduce the company's return on equity or lower future dividend payments in the short-term. The company may address these concerns by leveraging the balance sheet to increase potential returns when they undertake the major development of the McPhillamys project, with little in way of putting their company at risk.

Based on the current stock price of $3.47, the company appears to be undervalued under all the metrics we use – the EV/AISC-Adjusted Production measure sitting at $5 359/oz, EV/Resources at $202 and EV/Reserves at $430/oz while it is delivering at a profit margin of $926/oz. We believe that the fair valuation range for the company would be an EV/AISC-Adjusted Production of $7 500-$10 500, or $4.43-$6.77. With strong cashflow generation, a generous dividend yield that is now around 4.6% and short-term growth in production, they are currently an attractive investment, in our view. We have increased our exposure to this stock in the recent month and look forward to being rewarded further as the company gains further momentum in its major growth phase.

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Prevailing Environment

The recent six months have seen the gold price decline after having reached a peak in mid-2020 in the context of massive central bank cash printing and government spending to encourage economic activity during the Wuhan virus outbreak worldwide. The seasonal decline in the gold price from mid-September to mid-December continued into January 2021 as the Biden administration was inaugurated. Interestingly the market expected a higher stimulus package from the Biden administration than the $1.9 trillion that is currently agreed upon. On top of that, the cryptocurrency market appears to have attracted a lot of investors and hence this may have left the precious metals market stagnant.

Given the unprecedented unusualness of events that have emerged worldwide the last year, we believe that events should not be taken at face value. We hold to the belief that the financial system is currently being heavily controlled by central banks and financial institutions intent on maintaining the illusion of status quo in the backdrop of their desired plan of "The Great Reset" to be implemented by the World Economic Forum. However, we believe that the sharp rise in the cryptocurrencies market, the need for Treasury Secretary Janet Yellen to intervene on behalf of hedge funds to regulate against investors seeking to short-squeeze selected stocks in the market led by WallStreetBets, are examples of how their plan will not be successful.

The Australian dollar has strengthened by around 8% against the US dollar over the past six months and hence the gold price is trading around the $2 300-$2 400/oz mark. The crude oil price has surprisingly jumped almost 35% over the last six months, though much of the rise occurred from December onwards as the world began to believe that President Trump was unable to overturn the election results that appeared to favour Joe Biden. Given that the Biden administration campaigned heavily on climate change and green energy, the US oil production industry would suffer when he assumed office. The reduction in oil supply by the US and increasing reliance once more of the Middle East has contributed to the rising oil price. In turn, higher oil prices and the gold price being relatively stagnant have led to gold mining companies not being able to enjoy as accommodative operating environment than they had in the past year. That being said, the gold-oil ratio is still over 30, providing conditions that are still conducive to supernormal profits for mining companies.

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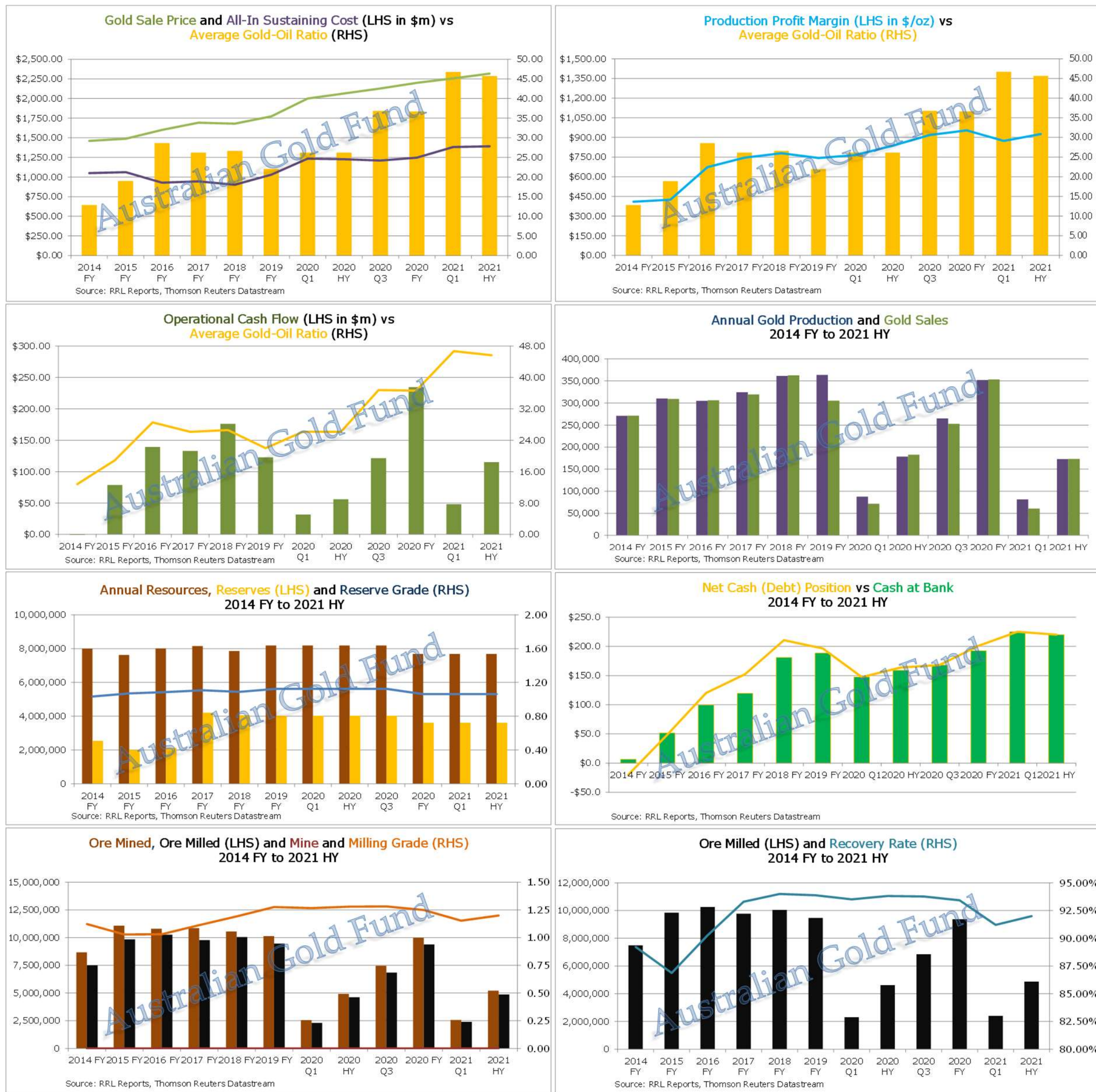
Operational and Financial Performance Charts



SWOT Analysis

<table>
<tr><td>Strengths
One of the strongest companies in the industry thanks to reliable management with a proven track record of generating cashflows and dividends for its investors.
Almost $500m paid in dividends since inception.
Growth phase to deliver substantial potential for investors by way of capital appreciation.</td><td>Weaknesses
Falling behind its peers in recent times due to their preference for organic growth that has only recently begun to offer tangible returns.
Management is somewhat conservative in their balance sheet management that may lead to their return on capital trailing its peers.</td></tr>
<tr><td>Opportunities
Increase in production in near-term with the Rosemont and Garden Well underground development.
Ben Hur, Gloster and McPhillamys underpin future growth in production and cashflows.
Balance sheet can be leveraged slightly to fund a more aggressive expansion to move it into the Large Producing Company category earlier.</td><td>Threats
AISC in their current operations has risen significantly in recent times.
Low grade ore in their existing deposits may further place upward pressure on costs as their operations go deeper beneath the surface.</td></tr>
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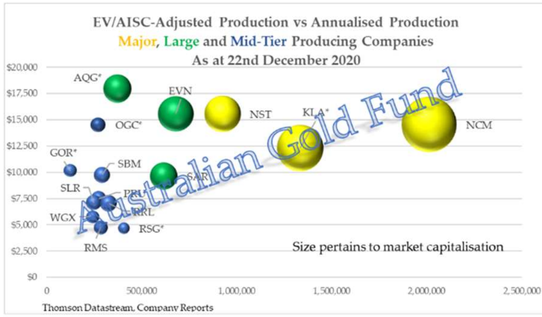
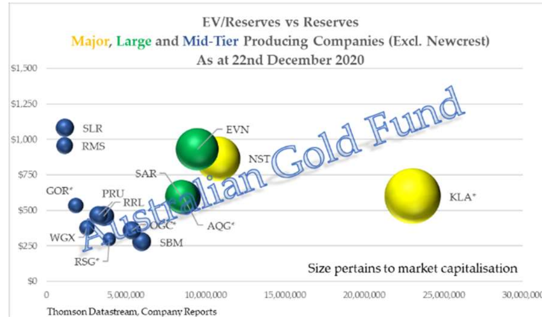
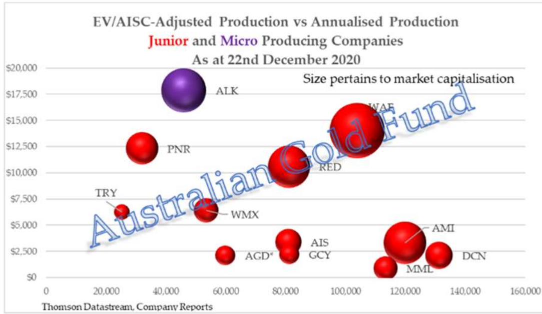
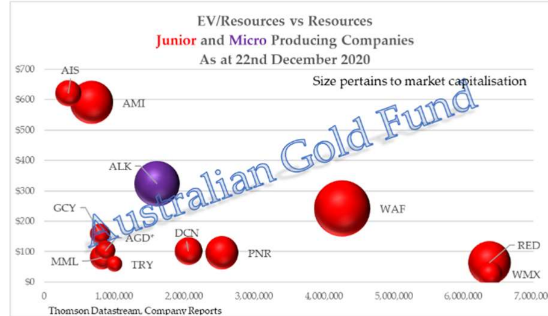
Peer Comparison









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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

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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*

We also add that after reviewing our reports, we have found another metric that may inform the fair value ranges, namely the Operating Margin. The Operating Margin is the difference between the Gold Sale Price per oz and the AISC. A higher Operating Margin implies higher cashflow generation. We have also found that the market appears to take this into account when determining the price they will pay to purchase the stocks. We found that there is a link between the Operating Margin and our EV/AISC-Adjusted Production in that 8-12 times the Operating Margin gives a reasonable EV/AISC-Adjusted Production.

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.

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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

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Declaration of Interest

The Australian Gold Fund and its directors currently own Regis 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.

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