Australian Gold Fund Valuation and SWOT Analysis

Resolute Mining Limited (ASX: RSG)

Date	7/08/2019
Classification	Mid-Tier Gold Miner
Current Price	$2.060
No. Issued Stocks (m)	900.6
Net Cash + Bullion + 0.5 x GIC ($ m)	-$82.99
Last Dividend Payment ($ p.a.)	$0.02
Market Capitalisation ($ m)	$1,855.22
Enterprise Value ($ m)	$1,938.22
Resources (oz)	15,970,000
Reserves (oz)	6,080,000

Ranking	**Fair Value**
Price Range	$1.475-$2.955
2020 Annual Gold Production Guidance (oz p.a.)	410 000-490 000
2020 All-In Sustaining Cost Guidance ($/oz)	$1 250-$1 450
EV/AISC-Adjusted Production Guidance ($/oz)	$5,909.00
EV/AISC-Adjusted Production Range ($/oz)	$5 000-$7 000
EV/Resources ($/oz)	$121.37
EV/Reserves ($/oz)	$318.79

Summary

Resolute Mining delivered their June 2019 quarterly at the end of July and also announced their acquisition of a private producing company, Toro Gold, for US$274 million (A$397m). The company expects their existing mine operations to produce 330 000oz at AISC $1 260/oz for the 2019 calendar year (also their financial year as they have also listed on the London Stock Exchange and changed their financial year end) as the Syama underground operations continue to gain momentum. With the acquisition of Toro Gold, with the Mako mine expected to produce 140 000-150 000oz for 2020, the company's gold production from July 2019 to June 2020 is expected to be up to 490 000oz at AISC $1 400/oz. The company's stock price rose almost 100% since the beginning of the June quarter and similarly since the start of the year on the back of a sharply increased gold price to over A$2 200/oz arising from the Federal Reserve cutting interest rates, a weakening dollar and also the operations ramping up in the Syama mine.

CEO John Welborn hosted a conference call combining the June quarterly report and the announcement of the acquisition of Toro Gold lasting an hour on 1st August. Production for the June quarter totalled 78 132oz at AISC of $1 340/oz, bringing the 2019 production to 305 436oz at AISC of $1 294/oz. Compared with the guidance of 300 000oz at AISC $1 280/oz, Resolute met the target. The Syama sulfide operations delivered 22 532oz of gold at AISC of $1 799/oz, a substantial improvement from a very weak previous quarter as a result of milling tonnage and ore grade improving. While commercial production status has been achieved at the end of June, it remains to reach the nameplate capacity. The Syama oxide production reduced from an exceptional level last quarter to 43 225oz at AISC of $780/oz and management indicates that this is the level of production to be expected in the future. The Ravenswood mine again performed weakly, producing 12 375oz at AISC of $2 345/oz. The underground mining is expecting to cease by the end of the year and replaced with open-pit mining from Nolans and Buck Reef West. Overall, the June quarter performance is on target, though somewhat extreme in that the Syama oxide mine delivered excellent results that outweighted less satisfactory performance in the Syama sulfide and Ravenswood mines.

The company continued to see significant cash outflow over the June quarter arising from poorer operating cashflow performance, working capital movement and a still-significant but decrease in capital expenditure. The company's cash balance fell from $32.5m to $13.2m, gold bullion on hand fell slightly from $22.1m to $21.1m while the total borrowings fell slightly from $198m to $193m. While the net debt position steepened further from $143m to $160m, John Welborn pointed out that peer companies are more leveraged than Resolute and the debt they currently have low interest costs. Given that the company should see the Syama operations stabilise, their debt position may reverse and a strong surge in the gold price may further allow this to occur sooner than many would anticipate.

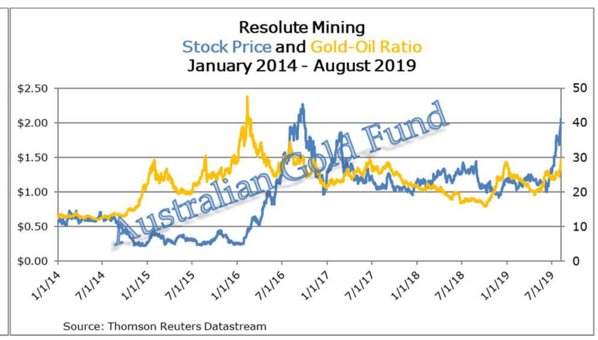
Regarding the Toro Gold acquisition, the transaction is financed with a cash payment of US$130m (A$190m) and US$144m (A$207m) of stocks priced at $1.45. Toro Gold has 928koz of reserves at 2.05g/t

http://goldfund.com.au

and 1.244Moz of resources, thus bringing Resolute Mining to reserves of over 6Moz gold (included net to Resolute) and resources of just under 16Moz. The Mako mine currently is expected to produce 140koz p.a. at AISC of A$1 130/oz throughout its seven-year mine life. As an open-pit mine, the cost is considered low and there exist underground exploration and development opportunities. Based on the price paid for the acquisition, the implied EV/AISC-Adjusted Production is $2 695/oz. This compares favourably against peer junior mining companies after considering a control premium has been accounted.

Of some concern is that post-acquisition, Resolute Mining will have debt approaching $500m and this is supported by around $190m of cash as well as $134m of gold-in-circuit yet to be released. Management has indicated that the GIC is being targeted for extraction under the Project 85 initiative. The Syama sulfide operations will see the carbon roaster being upgraded to improve recovery rates. Thus, considering that Resolute Mining will soon graduate to become a large producing company when annual production exceeds 500 000oz, the current financial position should raise no undue concerns. However, careful monitoring of the net debt position in the next two quarter is prudent.

Given the substantial rise of the gold price both in US and Australian dollar terms and the oil price weakening and expected to remain subdued in the future, gold mining companies have a rather rosy outlook. We have upgraded the valuation guidance to factor in this, as well as the increased scope of operations. At the current stock price of $2.06, the EV/AISC-Adjusted Production metric gives $5 909/oz, placing it in the mid-point of our range of $5 000-$7 000/oz. The company is currently deemed fairly valued.



Prevailing Environment

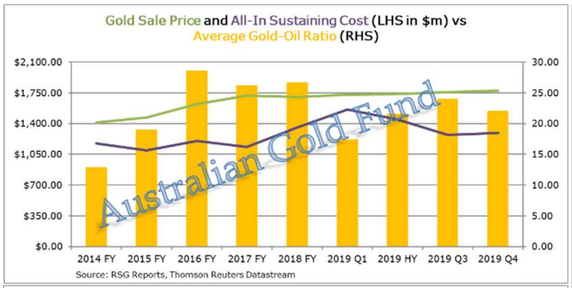
The first half of 2019 has seen the global financial markets make some recovery after a rather sharp decline in December 2018 as the Federal Reserve continued with their monetary policy of raising rates despite the real economy being weak, in conflict with the official economic and unemployment data. 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%.

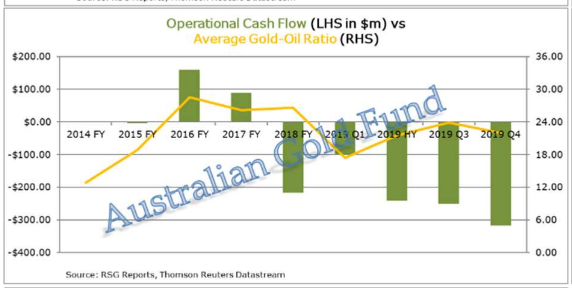
The change in the tone of the Federal Reserve is in conjunction with other central banks around the world taking a more dovish stance. The Reserve Bank of Australia surprised the market with a 0.25% reduction in early June 2019, taking it to 1.25%. This rate reduction comes as a result of a surprise 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.

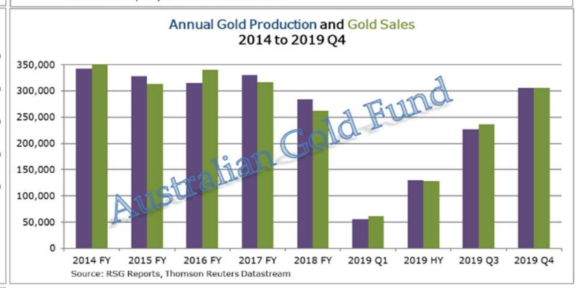
The gold price for most of early 2019 was rangebound between US$1 260-$1 350/oz, but this took a sudden turn after the June meeting on 19th June 2019 when the Federal Reserve indicated they were looking to start reducing rates as early as the July meeting scheduled on 30th-31st July. The gold price rose 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. With the July meeting leading to the Federal Reserve reducing the interest rate by 0.25%, the gold price continued to head upwards. Most interestingly, the gold price surpassed US$1 500/oz at the same time a twenty-year gold sale agreement among leading central banks expired and was not renewed. While many know that the physical sales of gold and precious metals do not move market prices as they are determined by the paper contracts, this is symbolic of what may potentially be the end of the suppression of precious metal prices to give an illusion of a stable petrodollar financial system.

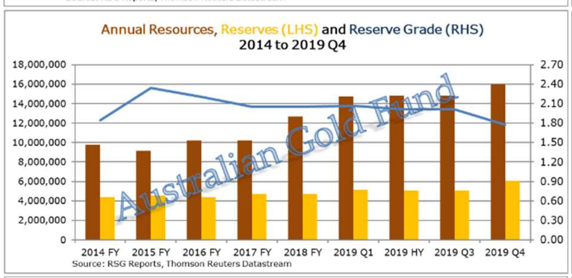
The oil price has been trading between US$50-$65/bbl on the backdrop of rising Middle East tension with Iran being in the spotlight. The US-Iran tension in the Persian Gulf and Strait of Hormuz briefly attracted much media attention and pushed the oil price above the US$60/bbl mark. This has now since been less at the forefront of market traders as increasing crude oil inventory and the escalation of the US-China trade wars takes a toll on economic activity and reduced the oil price approach US$50/bbl.

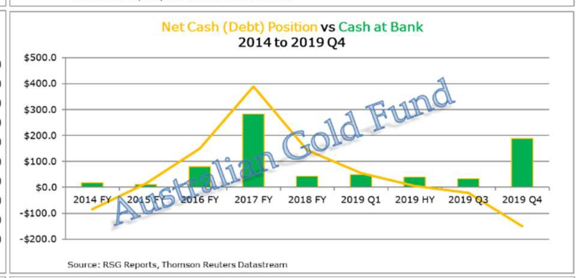
Operational and Financial Performance Charts

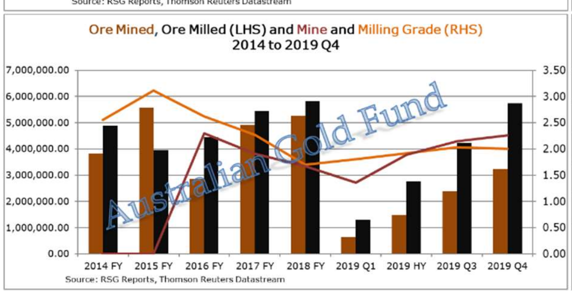


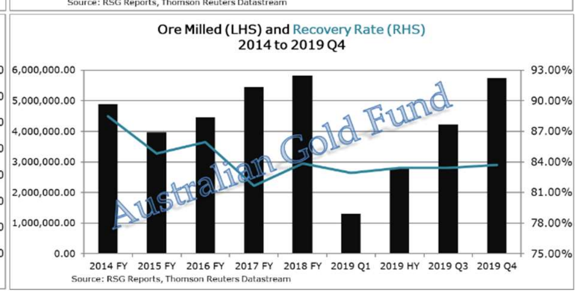










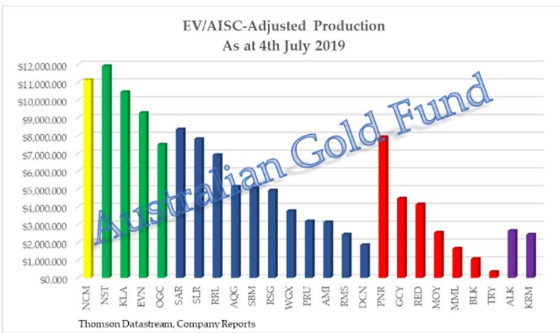


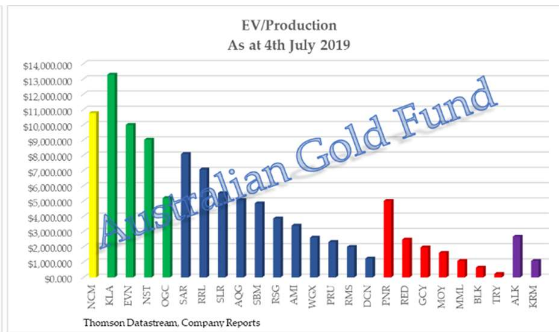
SWOT Analysis

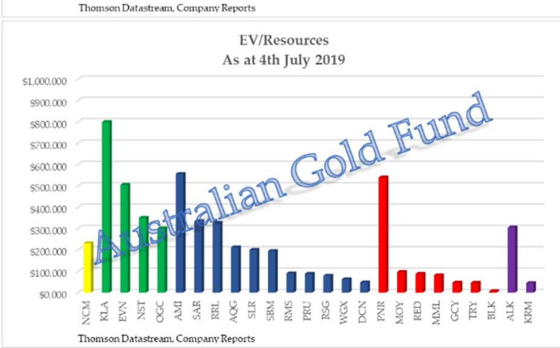
Strengths • Resolute is looking to become a large producing company through both organic development and acquisitions. • Management acquired Toro Gold at a modest price and demonstrated great timing.	**Weaknesses** • Budget blowouts in the Syama underground expansion and the Ravenswood expansion projects have left investors frustrated, especially due to operational delays and almost $400m cash expended.
Opportunities • The stabilisation of Syama and Ravenswood will generate substantial operational cashflows to assist with reducing debt and fund further development. • Further acquisitions of minority interests are possible, aided by higher gold price and	**Threats** • A substantial $500m debt load leaves investors nervous especially given the company's heavy cash burn over the last three years. • Further delays in the Syama underground mine and Ravenswood as well as integration issues with Mako could jeopardise company's financial viability.

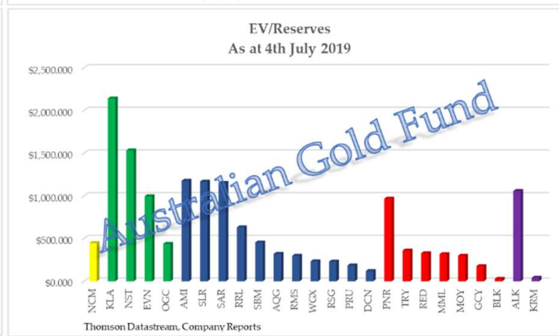
exploration and development companies need cash to proceed.	

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.

Declaration of Interest

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