Australian Gold Fund Valuation and SWOT Analysis

Resolute Mining (ASX: RSG)

Date	25/03/2021
Classification	Mid-Tier Gold Miner
Current Price	$0.465
No. Issued Stocks (m)	1,103.9
Net Cash + Bullion + 0.5 x GIC ($ m)	-$321.92
Last Dividend Payment ($ p.a.)	$0.00
Market Capitalisation ($ m)	$513.31
Enterprise Value ($ m)	$835.23

Operating Performance Metrics	
2021 Annual Gold Production Guidance	350 000-375 000
2021 All-In Sustaining Cost Guidance ($/oz)	$1 560-$1 650
2020 Operating Margin (Sale Price less AISC)	$693.75
Resources (oz)	8,479,000
Reserves (oz)	3,362,000
Financial Year Cumulative Production (oz)	395,137
Production as % of 2020 Annual Guidance	91.89%
2020 Financial Year Cumulative AISC ($/oz)	$1,562.90

Valuation Metrics	
Price Range	$0.67-$1.23
Overall Ranking	Undervalued
Current EV/AISC-Adjusted Production	$3,698.00
EV/AISC-Adjusted Production Range	$5 000-$7 000
Ranking	Undervalued
EV/Resources	$98.51
Ranking	Undervalued
EV/Reserves	$248.43
Ranking	Undervalued

Summary

Resolute Mining is a mid-tier gold mining company with operations in West Africa – the flagship Syama mine in Mali and the Mako mine in Senegal, producing annually at around 280 000-400 000oz at AISC of $1 400-$1 600/oz over the last three years. The company has fallen out of favour from many investors since 2017 after undergoing a prolonged period of capital development on its Syama mine and also the Ravenswood mine in Australia, which it sold to EMR Capital last March for a combination of cash and royalty payments on various development and production milestones.

The company has had its lion share of woes, with the latest being the Ghanaian government requiring the Bibiani project to cease operations and its mine license being suddenly terminated on 23rd March, even as the project is due to be sold to Chinese owned Chifeng Jilong Gold Mining Company for US$105m (approximately A$140m). The reason behind this abrupt change of stance by the Ghanaian government is unknown but indeed left investors with a very bitter taste in their mouth, pushing the stock price down some 25% today when it resumed trading after a one-day trading halt.

Over 2020, Resolute Mining produced 395 137oz of gold at AISC of A$1 563/oz, with the Syama Sulfide mine producing 123 499oz at AISC A$2 120/oz, Syama Oxide 90 860oz at A$1 251/oz, Mako 169 732oz at A$1 173/oz and Ravenswood 11 046oz at A$2 334/oz up to March 2020. This result was below the 430 000oz at AISC of US$1 260/oz (A$1 600/oz) at the start of the year after factoring out the Ravenswood production given its sale.

The Syama mine complex appears to be a rather complex issue for the company given the previous CEO, John Welborn, had spent some $300m into developing the underground mine to include innovative automated excavation and trucking technology. For what it was worth, this investment is still yet to show its value some two years into its operation at commercial capacity. By the end of 2020, the Syama sulfide mining tonnage is over 2Mt, still under the 2.4Mt nameplate capacity with the December 2020 quarter reporting 577kt of ore mined. We hope to see 2021 is the year where it is third time lucky and the mining and processing rates will reach the nameplate capacity, thus bringing costs down and recouping its investment.

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At the same time, the Syama Oxide mining operations are transitioning to the Cashew open pit with some 2.5Mt of oxide ore stockpiled will be processed over the next two years to meet the production capacity. The stockpiled ore grade is 1.36g/t, markedly lower than the long-term average ore grade of 2-2.7g/t. Depending on the scale of processing, we expect that the Syama Oxide mine to deliver gold at higher AISC until the Tabakaroni pit, which is a 0.43Moz reserve at 4.6g/t and is at Pre-Feasibility Study stage as at mid-October 2020, is in operation. The 2021 projected production for Syama Sulfide is expected to be higher at 155 000-170 000oz at AISC of around A$1 550-$1 650/oz while for Syama Oxide it will be lower at 80 000-85 000oz at A$1 350-$1 400/oz.

The Mako mine in Senegal, acquired in late July 2019 from Toro Gold, is one of the few saving graces for the company. As mentioned in the report, this mine delivered ahead of expectations on all fronts, with mined ore of 2.30Mt at 2.3g/t, ore processed of 2.08Mt at 2.69g/t and 93.4% recovery rate. Prior to the lockdowns, the Mako mine was mining at over 700kt in a quarter although it appears they are returning to that rate in the coming year. To add to the positive news about this mine, the updated LOM performed middle of last year showed Mako is estimated to produce 1.24Moz over 9 years, 39% up from the initial expectation of 890 000oz over seven years when the mine was acquired. The mine has some 2.5Mt of lower grade ore to supplement higher grade mined ore going into the future. Production for 2021 is expected to be lower at 115 000-120 000oz at AISC of A$1 400-$1 550/oz.

The balance sheet and debt position for Resolute Mining over the last five years have been disappointing, to say the least. Investors had possibly been run to the end of their tether of promises that the massive capital expenditures would begin to see the company's net debt position turn around without selling their existing assets. The author was once a strong supporter of this company's future prospects after having experienced a fantastic run from mid-2014 to late-2016, only to end up having to concede this was misplaced. The company does have a solid cash balance of A$115m with A$12.8m of bullion on hand while short-term debt amounts to A$95.6m and long-term debt amounts to A$370.6m, giving a net debt position of around A$340m. The company has a promissory note receivable worth A$50m and a potential A$200m contingent payments on the future production of the Ravenswood mine. The Tabakoroni deposit is expected to cost around A$100m-$110m to develop while the company's operational cashflows are appearing to be somewhat volatile given that the Syama mine AISC has been stubbornly high.

Taking into the shocking decline in the company's stock price owing to the Bibiani mine sale looking like it will not go ahead for now, it appears there is a dark cloud hanging over the company with its history of disappointments the last four and a half years. However, putting aside the emotions and recency bias, the company is still producing 350 000-375 000oz of gold this coming year at AISC of A$1 560-$1 650 based on our estimates. Despite its heavy debt position, a large proportion of will mature beyond one year's time giving the company some breathing room. The company has 3.36Moz reserves and 8.48Moz resources, and the existing properties have seen the ore reserves increase slightly after depletion. The current EV/AISC-Adjusted Production is very low at $3 700/oz while EV/Reserves is $248/oz and EV/Resources is $99/oz. Hedging of their gold production is 133 000oz at around A$2 200/oz, or 35% of their

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production, so we estimate that the profit margin for the company in the coming year will be around $700/oz.

Based on our fair valuation range of EV/AISC-Adjusted Production of $5 000-$7 000/oz, this implies the company should be fairly valued at $0.67-$1.23. We do recognise that the investor sentiment will continue to remain poor so we are holding off from adding to our existing holdings until the dust settles and we may well pass on this opportunity for better options.

Prevailing Environment

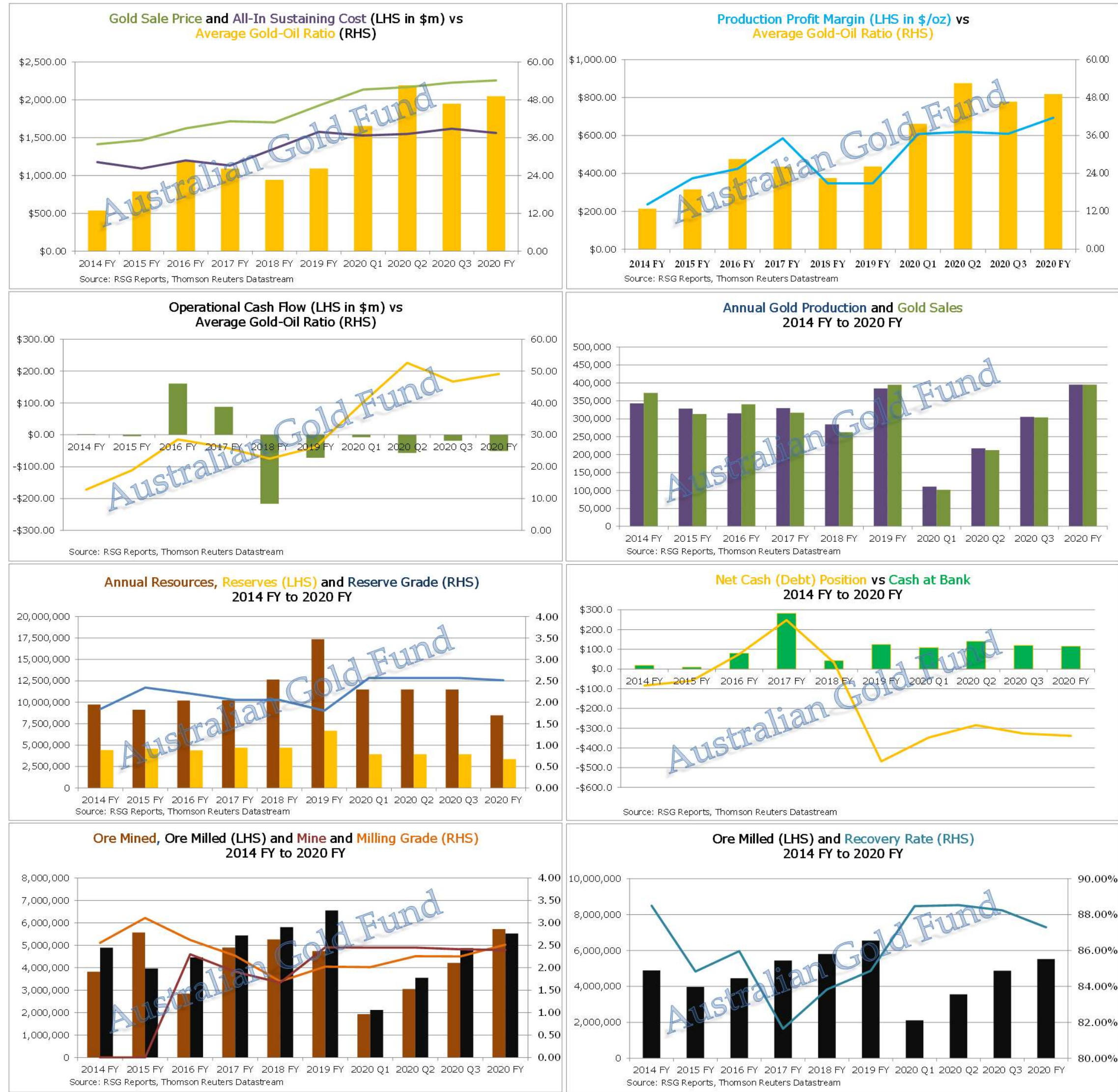
The recent six months have seen the gold price decline after having reached a peak in mid-2020 in the context of massive central bank cash printing and government spending to encourage economic activity during the Wuhan virus outbreak worldwide. The seasonal decline in the gold price from mid-September 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 but is appearing to turn aro 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.

Operational and Financial Performance Charts



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SWOT Analysis

Strengths	**Weaknesses**
• Substantial annual production with long mine life properties. • Cash balance is solid with adequate funding capacity due to company scope.	• Operations have had a disappointing track record of high-cost production and investment decisions that have yet to pay off. • Doubts are mounting over the legal stability of its operations given the Bibiani incident. • Company has been increasingly geared and repaying debt through selling assets, which is not conducive to growth in longer term.
Opportunities	**Threats**
• Syama mine expansion continues in the Oxide operations with development of the substantial and high-grade Tabakaroni deposit. • Egyptian joint ventures may provide future production opportunities, though these are very early stages in the mining cycle.	• Company has been shrinking its production profile while investing instead in development projects that take time to deliver cashflows. • Persistent high cost in the flagship Syama operations have been a worry for long-term holders of the stock. • Increasing political incidents in West Africa including the Mali coup last April and the Ghanaian government's cancellation of the Bibiani license bring doubt on whether the company's assets are safe.

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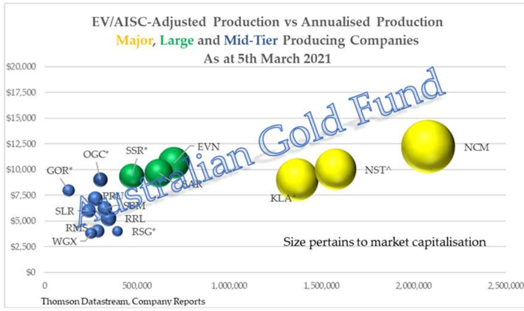
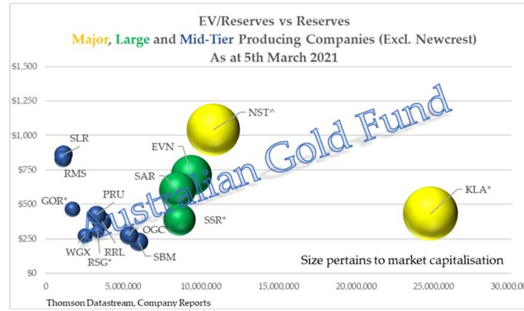
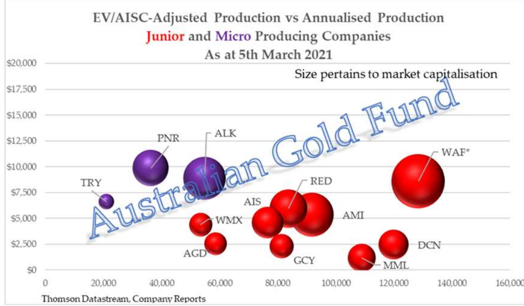
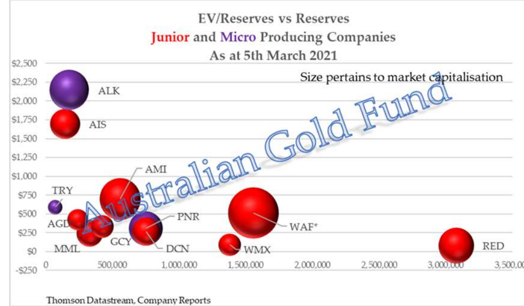
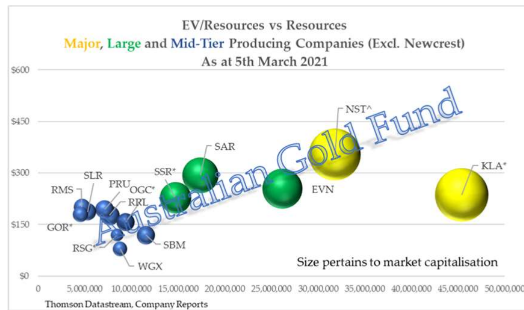
Peer Comparison

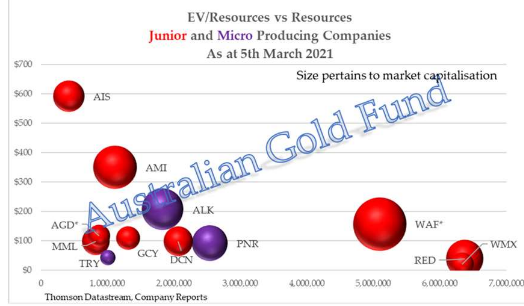












Valuation Thesis

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

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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

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 Resolute Mining 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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