Australian Gold Fund Valuation and SWOT Analysis

Saracen Mineral Holdings Limited (ASX: SAR)

Date	30/05/2019
Classification	Mid-Tier Gold Miner
Current Price	$3.190
No. Issued Stocks (m)	820.3
Net Cash + Bullion + 0.5 x GIC ($ m)	$131.80
Last Dividend Payment ($ p.a.)	$0.00
Market Capitalisation ($ m)	$2,616.67
Enterprise Value ($ m)	$2,484.87
Resources (oz)	8,600,000
Reserves (oz)	2,500,000

Ranking	**Overvalued**
Price Range	$1.88-$2.915
Annual Production Guidance (oz p.a.)	345 000-365 000
All-In Sustaining Cost Guidance ($/oz)	$1 050-$1 100
EV/AISC-Adjusted Production Guidance ($/oz)	$7,549.00
EV/AISC-Adjusted Production Range ($/oz)	$4 500-$6 500
EV/Resources ($/oz)	$288.94
EV/Reserves ($/oz)	$993.95

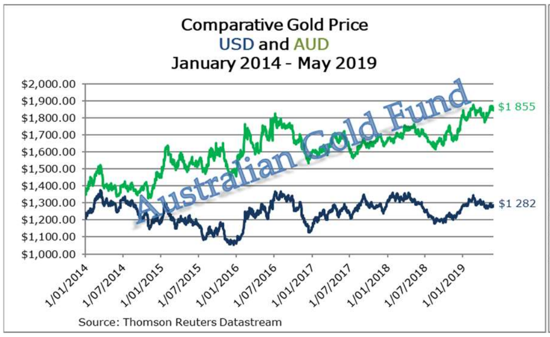
Summary

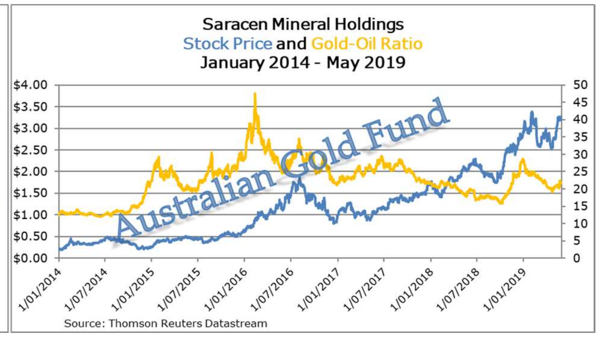
Saracen Mineral Holdings is a mid-tier gold producing company that has delivered reliable performance and steady cashflow generation over the last four years. The company is on track to deliver 400 000oz p.a. in the coming two years. Over this past financial year, Saracen has overdelivered on their guidance while continuing to maintain a conservative forecast on their future performance. Investors have not been fooled by the management's cautious approach to their outlook, with the stock price rising strongly over the past five years when it was trading below $0.20 in early 2014 and now being more than 15 times that price.

The company delivered 89 208oz over the March quarter at AISC of $1 035/oz, compared to 88 834oz at AISC $1 067/oz in December. The company has maintained their 2019 guidance at 345 000-365 000oz at AISC $1 050-$1 100/oz, while their year-to-date progress is 266 982oz at AISC $1 032/oz. Assuming performance for the June quarter is similar to that in March, the company will be able to meet the midpoint of their current guidance on production and exceed the AISC target. Note that the company has already upgraded their guidance in the December quarter.

Management has signalled that they are aiming to continue to expand on their underground operations at the Thunderbox mine, which has commenced production in the December quarter but has not yet reached commercialisation stage. The Carosue Dam mine has been steadily producing gold and management has indicated spending $23m on the Karari exploration project. Interestingly, the company's mining and processing operations have been reliable and steady, which cannot be said about many mining companies. Management has plans to further expand their Thunderbox processing plant from 3Mt p.a. to 3.2Mt p.a. At the current stage of processing, Saracen is expected to break past records on milled ore this year. As the Thunderbox underground mine gains momentum, expect ore grades to further improve and hopefully AISC will further decrease below $1 000/oz.

Saracen has found a sweet spot for themselves, which would be a source of envy from its peers. The company has generated positive operating cashflows net of maintenance capex of $260m since 2014, with over half of this being generated this financial year thus far. Given such strong cashflow generation, management may even contemplate paying a maiden dividend for the end of this financial year, though this is pure speculation. Thus, investors have reasons to strongly buy into this company as they have over the past nine months. However, we maintain the view that investors may have moved ahead of themselves based on our valuation metrics. Currently, the company's EV/AISC-Adjusted Production is at levels comparable to large gold producing companies such as Evolution Mining and Northern Star. At the current price level, Saracen is overvalued. However, as the company approaches their goal to produce 400 000oz p.a., the current price level is fair.



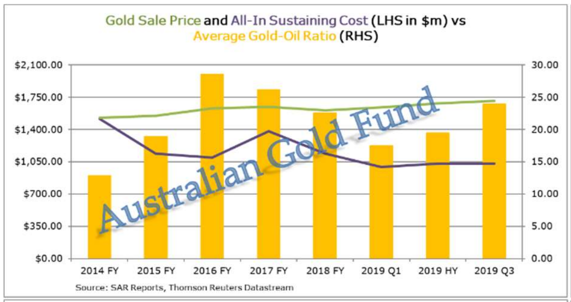


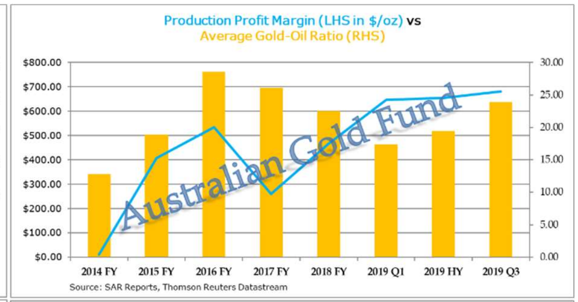
Prevailing Environment

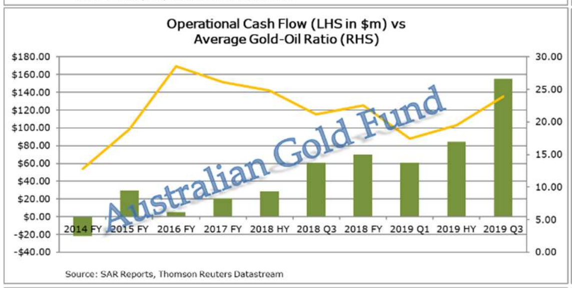
The March quarter has been a challenging one for many gold mining companies despite the gold price trading in the US$1 280-1 345/oz and A$1 790-1 880/oz range. Part of this is caused by the oil price rising 33% from US$45/bbl to US$60/bbl during the quarter, leading to the gold to oil ratio placing some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

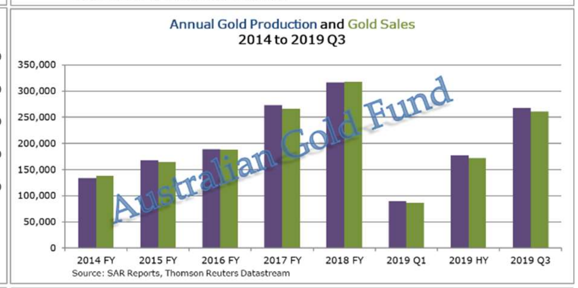
Since the end of the March quarter, the gold price has further weakened while the oil price has increased. The gold to oil ratio has fallen to the 20-21 mark, but there are signs that the gold price is nearing a bottom while the oil price is falling. The months of April and May tend to be cyclical bear periods for gold, with June and July seeing its price recover. This may be repeated in 2019 as the global stock markets are again approaching a peak.

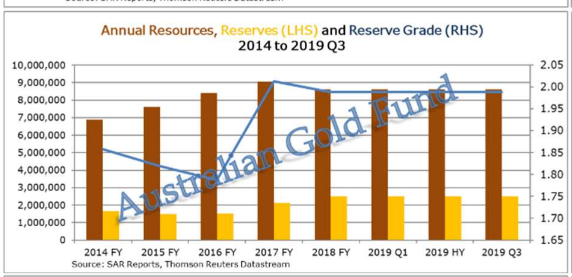
Operational and Financial Performance Charts

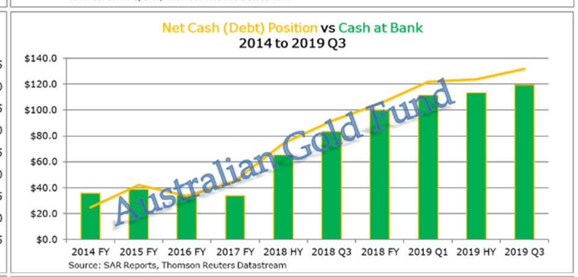


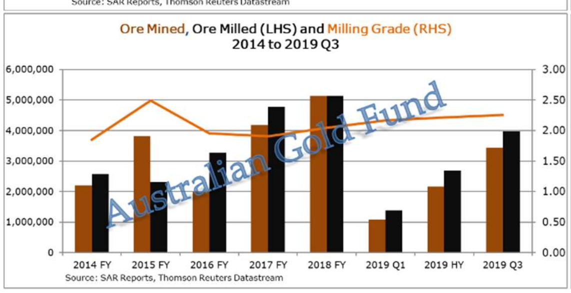


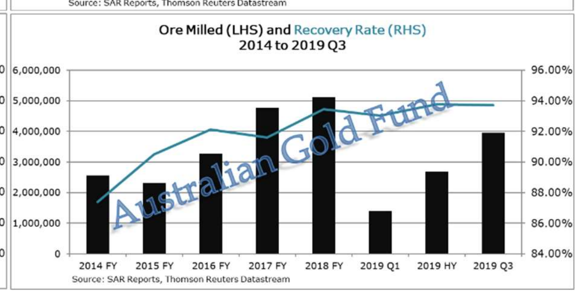








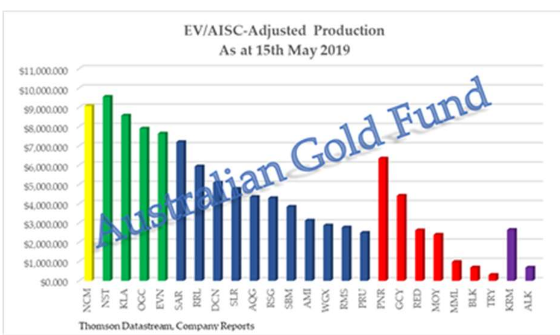


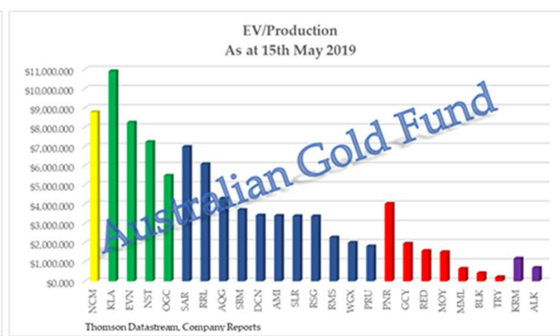


SWOT Analysis

Strengths	Weaknesses
• Underpromises on production and cost targets but subsequently overdelivers. • Reliable mining and processing to facilitate strong cashflow generation and rising production levels.	• Investors potentially pricing this company's stocks to perfection. • Despite strong performance, company has yet to distribute dividends, though possible for the end of this financial year.
Opportunities	**Threats**
• Management is expanding on their two existing operations, with some $60m budgeted this year for exploration. • Acquisitions of neighbouring mines may be possible to increase their reserves base given their strong cash balance and cashflow generation capabilities.	• Underground mining can lead to rising costs if the ore grades are poor or they encounter problems with hard ore or machine breakdown.

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