Australian Gold Fund Valuation and SWOT Analysis

Silver Lake Resources Limited (ASX: SLR)

Date	5/07/2019
Classification	Mid-Tier Gold Miner
Current Price	$1.250
No. Issued Stocks (m)	818.2
Net Cash + Bullion + 0.5 x GIC ($ m)	$137.40
Last Dividend Payment ($ p.a.)	$0.00
Market Capitalisation ($ m)	$1,022.72
Enterprise Value ($ m)	$885.32
Resources (oz)	4,521,000
Reserves (oz)	776,000

Ranking	**Overvalued**
Price Range	$0.885-$1.23
2020 *Est* Annual Gold Production Guidance (oz p.a.)	235 000-250 000
2020 *Est* All-In Sustaining Cost Guidance ($/oz)	$1 150-$1 200
EV/AISC-Adjusted Production Guidance ($/oz)	$4,290.00
EV/AISC-Adjusted Production Range ($/oz)	$3 000-$4 000
EV/Resources ($/oz)	$195.82
EV/Reserves ($/oz)	$1,140.88

* Estimates are discretionary to include some personal judgment by the author

Summary

Silver Lake Resources is a mid-tier gold mining company with two operating mines – the Mount Monger mine and the Deflector mine that they acquired in early April in a merger with Doray Minerals. The company stock price has increased by 125% since the start of the year, and including the merger with Doray Minerals, the market capitalisation has risen from $280m to $1.023 billion. Much of the rise in price has been due to the rise in the gold price as well as the company's growing cash balance from their operations. The company is expected to generate around 235 000oz of gold in 2020, as foreshadowed in their presentation for the merger. At the end of June, the company has released some encouraging drilling results at the Deflector mine. Furthermore, the Mount Monger mining volume appears to be picking up volume, despite a decline in the mined grade, and the Deflector mine is seeing mining volume and ore grade improving. These may underpin stronger results going forward.

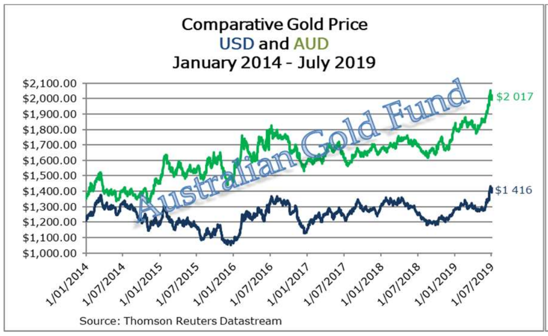
Silver Lake Resources has spent the last five years languishing behind its mid-tier peer companies. While the company continued to replenish their mined ore in the Mount Monger operations, they had downsized their operations by selling the Murchison and the Great Southern projects as well as the Tuckabianna processing plant. The company's production fell from 215 000oz in 2014 to 125 000oz in 2015 and the reserves halved from 970 000oz in 2016 to 460 000oz in 2017. During this time, the company did accumulate a larger cash balance but this was not enough to satisfy shareholders who sold the stock down in 2015 and kept it at below $0.20.

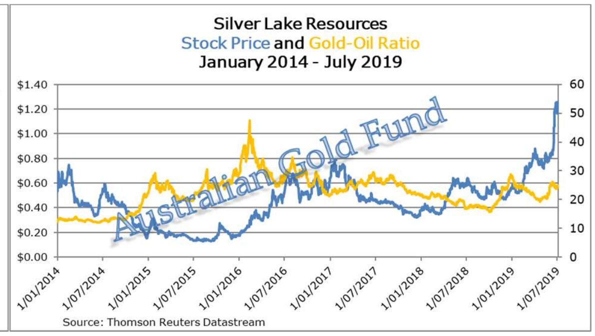
As the company reduced their scope and accumulated cash, they did not appear make any acquisitions or formulate expansion plans beyond developing their Mount Monger operations. The Mount Monger operation, to the company's credit, did deliver solid operating cashflows and the grades were largely maintained. When the company made the offer to merge with Doray Minerals in late 2017, this was well-timed as the gold price was beginning to rise and Doray Minerals had only begun to show clear signs that the worst was behind them.

With the merger, Silver Lake Resources has cemented themselves as a high-grade mid-tier mining company with strong cashflow generating capabilities. The Deflector mine has turned around Doray Minerals after the disastrous 18 months for the company when their Andy Well mine was put into care and maintenance after its costs escalated. The Deflector mine has increased its momentum thanks to the Doray CEO Leigh Junk implementing the 1-5-1 plan earlier in 2018 to increase production to over 100 000oz p.a. at below AISC of $1 000/oz and seeking to expand the mine life beyond five years. With a drilling campaign yielding results, this may benefit Silver Lake Resources in the longer term.

Going forward, the company has a sizable cash balance of over $100m, two underground mines delivering as much as 250 000oz p.a. at grade over 3g/t at AISC in the $1 200/oz range. With lower oil price and strong gold price expected given the slowdown of the global economy and a dovish monetary policy from the Federal Reserve and other central banks, the company may be in a sweet spot. However,

the company currently has the lowest reserve life among its peers of around 3 years. Much attention will be placed on the company's 2019 Resources and Reserves Statement to see if the higher gold price sees conversion of resources into reserves as well as exploration successes. Given they have relatively good grades and have been generating significant operating cashflows, an EV/AISC-adjusted production range of $3 000-$4 000 is warranted. Despite this, the company's current stock price of $1.25 deems it overvalued. If their 2020 guidance be upgraded and their resources and reserves increase dramatically, further re-rating may be possible.



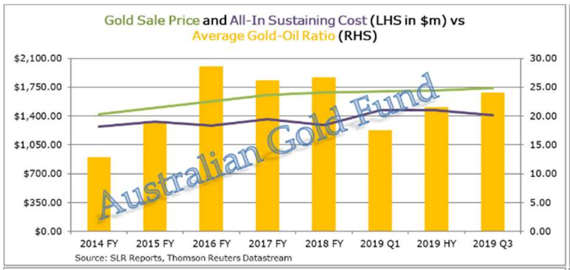


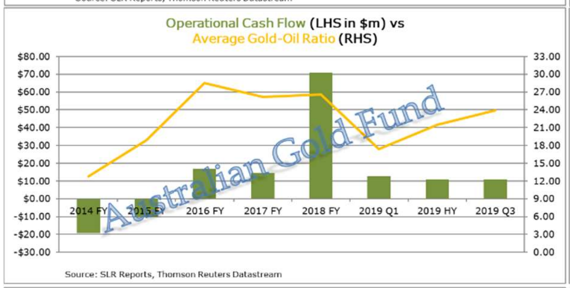
Prevailing Environment

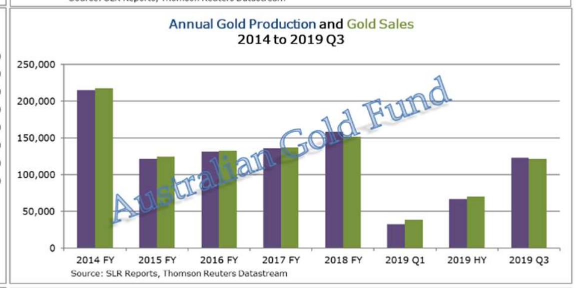
The March quarter has been a challenging one for many gold mining companies despite the gold price trading in the US$1 280-1 345/oz and A$1 790-1 880/oz range. Part of this is caused by the oil price rising 33% from US$45/bbl to US$60/bbl during the quarter, leading to the gold to oil ratio placing some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

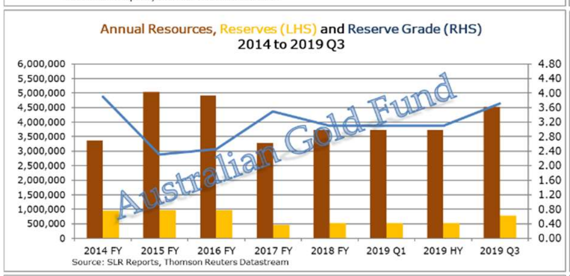
Since the end of the March quarter, the gold price weakened to below US$1 300/oz while oil held above US$60/bbl until late May when the US Federal Reserve had a change in tone regarding interest rate rises going forward. Other central banks have indicated rate cuts may occur in the future. Furthermore, the oil price weakened sharply as the US Department of Energy revealed that their crude oil inventory has increased. By mid-June, the gold price has risen to the US$1 330-$1 350/oz range, while breaking the all-time records for the Australian dollar. This extended further on 24th June when the gold price exceeded US$1 400/oz for the first time since 2013. The Australian dollar gold price also exceeded the psychological barrier of $2 000/oz. With oil price in the mid-50's, this is an excellent backdrop for gold and other resources companies to operate. Noting also that the Reserve Bank of Australia has reduced interest rates twice in June and July to 1%, the tailwinds for gold and gold miners will likely continue.

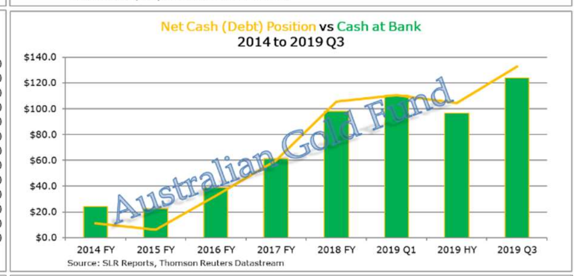
Operational and Financial Performance Charts

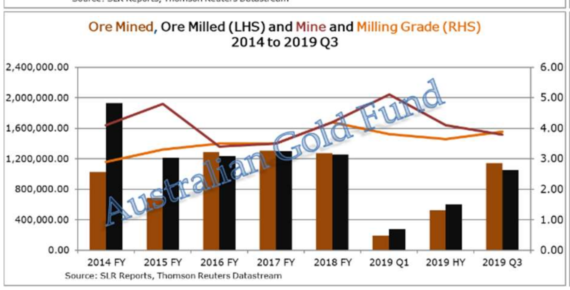


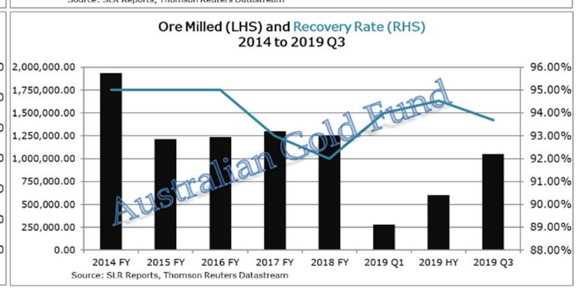








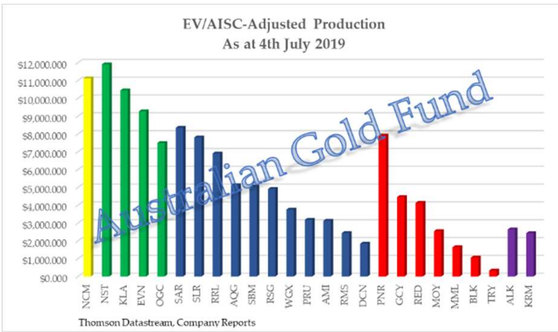


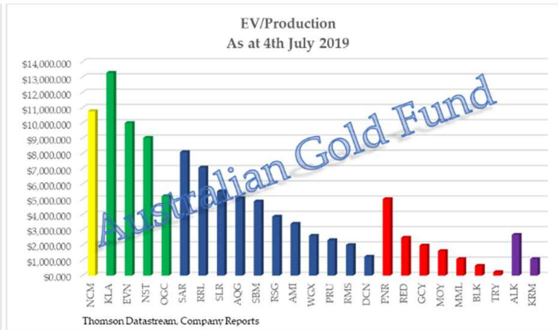


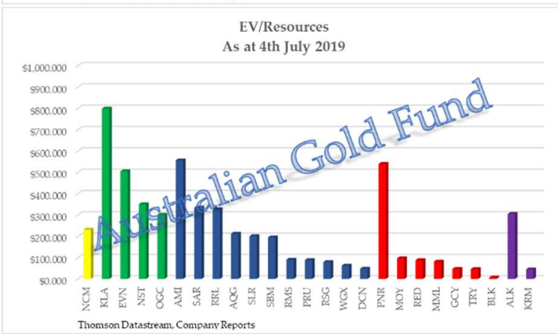
SWOT Analysis

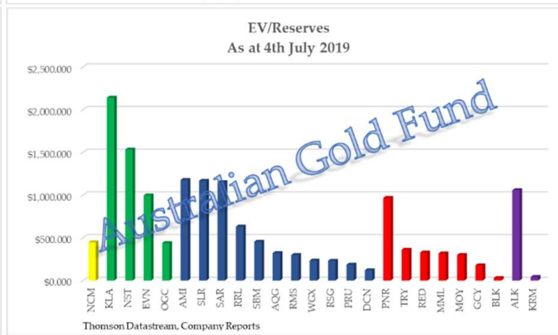
Strengths	Weaknesses
• Strong cash balance with no debt. • Two underground mines with solid grades that underpin operating cashflow generation.	• Low reserves and mining life of around 3 years. • Company has been reducing their operation scope only until recent Doray merger.
Opportunities	**Threats**
• Strong mining grades in recent exploration campaigns may result in substantial conversion of reserves from resource base. • High cash balance may allow further acquisition. • Strong gold price and lower oil price act as tailwind on company operations and cashflow generation.	• Slow conversion of reserves and resources may not be sufficient to replenish ore that is depleted through mining.

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

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