Australian Gold Fund Valuation and SWOT Analysis
Silver Lake Resources Limited (ASX: SLR)

Date	29/06/2020
Classification	Mid-Tier Gold Miner
Current Price	$2.090
No. Issued Stocks (m)	879.8
Net Cash + Bullion + 0.5 x GIC ($ m)	$227.45
Last Dividend Payment ($ p.a.)	$0.00
Market Capitalisation ($ m)	$1,838.87
Enterprise Value ($ m)	$1,611.42

Operating Performance Metrics	
Annual Gold Production Guidance *2020 Estimate* (oz p.a.)	250 000-260 000
All-In Sustaining Cost Guidance *2020 Estimate* ($/oz)	$1 300-$1 350
Operating Margin (Sale Price less AISC)	$792.33
Resources (oz)	5,746,000
Reserves (oz)	1,070,000
Financial Year Cumulative Production (oz)	193,355
Production as % of Annual Guidance	74.37%
Financial Year Cumulative AISC ($/oz)	$1,276.58

Valuation Metrics	
Price Range	$1.415-$1.85
Overall Ranking	Overvalued
Current EV/AISC-Adjusted Production	$8,373.00
EV/AISC-Adjusted Production Range	$5 500-$7 000
Ranking	Overvalued
EV/Resources	$280.44
Ranking	Fair Value
EV/Reserves	$1,506.00
Ranking	Overvalued

Summary

Silver Lake Resources (ASX: SLR) has delivered two consecutive quarters of strong performance resulting in upgrades to the 2020 full year guidance in a year that has seen many producers downgrading and underperforming. The company is on track to deliver an annual production that is almost 20% above their initial guidance almost a year ago. Furthermore, the company has built up a substantial cash balance and with the acquisition of Egan Street Resources being gradually incorporated, the company is building their future potential in becoming a competitive low-cost mid-tier producer.

The results released for the March 2020 Quarter were quite robust, though not as spectacular as their December 2019 Quarter where the company delivered record quarterly production. The company delivered 65 548oz of gold at AISC of $1 380/oz, with production being around 5% less than the December 2019 Quarter where production was 68 519oz at AISC of $1 192/oz. The Mount Monger operation delivered record mine production of 41 971oz recovered at AISC of $1 463/oz while the Deflector operation delivered production of 23 577oz at AISC of $1 232/oz, around 6% less than the record production in the prior quarter. Whichever way one wishes to see it, the two mines are performing strongly for the company. Management considered the strong trend in their operations in upgrading their 2020 guidance to 250 000-260 000 gold equivalent oz at AISC of $1 300-$1 350/oz, up from the previous quarter's guidance of 230 000-240 000 gold equivalent oz, with AISC remaining steady.

The company's cash and bullion balance has increased to $227m, up some $96m since the start of the year, which is an impressive result given the company has so far sold just under 200 000oz of gold. This provides them with substantial capital for developing their Rothsay deposit, undertake further exploration in their existing mine properties, expand the Deflector processing plant, commence underground development of their Mount Monger deposits as well as pursue further acquisitions of more mine projects. Given several transactions have occurred in the gold mining industry with companies being acquired (e.g. Egan Street Resources by Silver Lake Resources, Exore Resources by Perseus Mining, Spectrum Minerals by Ramelius Resources, Detour Gold by Kirkland Lake Gold, merger between Alacer Gold and Silver Standard Resources, etc.) and mines or deposits being purchased (e.g. Kalgoorlie Super Pit being jointly acquired by Northern Star and Saracen, Red Lake Complex being acquired by Evolution Mining, etc.), we can see that the industry is consolidating.

Several more explorers and developers may be lining up to be acquired by larger players in the industry as a cheaper alternative in expanding their resources and reserves base than exploration.

Going forward, management has indicated that they will be investing capital to develop the Rothsay deposit that will feed the Deflector processing plant in the first quarter of 2022, which itself is scheduled to be expanded around that time. The company has also begun to produce ore in the Santa underground deposit in the Mount Monger mine, which will look to add to the mine's production of high-grade ore. The Karonie South pit deposit has also begun to produce ore and is expected to be milled in the second half of 2020, or the 2021 financial year. This deposit will be expected to deliver up to 86 000oz over an 18-month period. The company has also been experiencing an improvement in the mined ore grade as well as the ore being processed at Mount Monger, rising from 3g/t to 3.6g/t of mined ore and 3.5g/t to 4.6g/t of processed ore over the past 12 months. With further development of underground deposits as well as an expanded processing capacity at the Deflector plant, this could further act to reduce the AISC and increase production going forward.

The company is moderately hedged on its production, with the following hedge positions as at 31st March 2020:

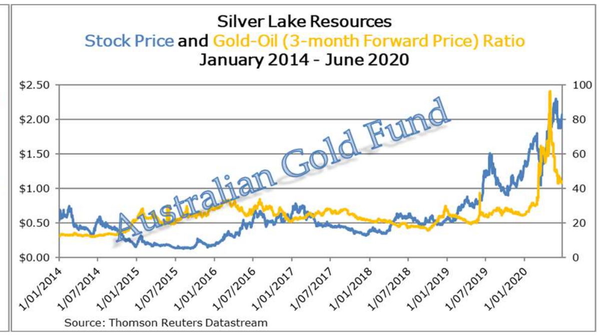
	Total	Jun-20 HY	Dec-20 HY	Jun-21 HY	Dec-21 HY	Jun-22 HY
Ounces (koz)	184,000	28,432	38,068	30,000	42,000	45,500
Hedged gold price (A$/oz)	2,100	1,845	1,884	1,928	2,333	2,341

Table 6: Silver Lake hedge book as at 31 March 2020

The company has hedged around 40% of its production in the June 2020 quarter, around 25% of the December 2020 half year production and around likely less than 20% of production, thereafter. The prices that the company has locked for the 97 000oz of production to June 2021 are some 25% below the current spot price and comprise some 30-35% of production. However, we note that many mid-tier producers are in a similar position and at the time the company secured these hedges, it seemed to be a prudent move. The company is still substantially exposed to the upside in the gold price movement during the next 2 years, despite the hedge position.

The current stock price for Silver Lake Resources is $2.09, giving the company an approximate market capitalisation of $1.84 billion and an enterprise value of around $1.61 billion. While the company has delivered robust performance and is one of the best performers in the industry this year, we note that based on the company's 2020 production and cost guidance, the company's fair valuation range should be $1.415-$1.85. We have upgraded the company's valuation range given their outperformance against their own benchmark. In terms of the company's current value relative to its resources and reserves, the metrics do not sway our view too much. The company currently has around 1.07Moz of reserves and 5.75Moz of resources, although this is expected to increase as a result of the recognition of the exceptionally high-grade ore in Deflector South West and other exploration successes. That being said, the current levels of reserves and resources may be somewhat low and hence we believe that it is prudent to wait for more firm numbers to arrive before raising the price target further.

Prevailing Environment

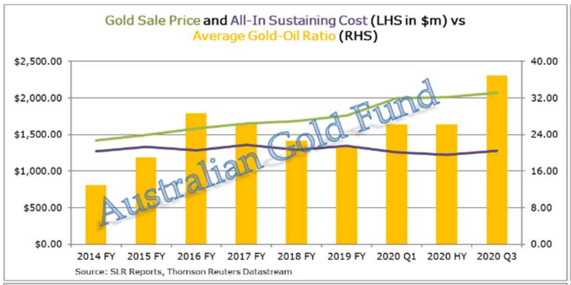


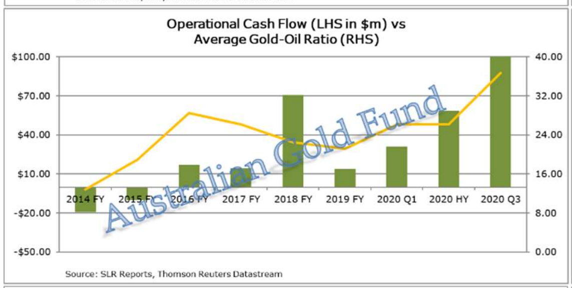
The recent four months have seen the world and the global financial markets face some monumental events that have made a lasting impact, and will expect to steer the world in a different trajectory hereafter. A combination of events starting with the US-Iranian conflict (who still remembered this?) in early January, the spreading of the coronavirus leading to a pandemic starting late last year, the collapse of OPEC talks in early March and then the sharp global market crash from late February to March have shaken nations, corporations and households alike. In the midst of this, most market indices around the world declined 25-40%, most commodity prices fell (except for gold) and so did cryptocurrencies (though some have bounced to back and more). The Federal Reserve cut their interest rate to 0-0.25% by mid-March, bringing them back to late-2008 at the onset of the subprime crisis. In addition, the Federal Reserve Board of Governors has indicated that they will have almost unlimited capacity to create currency to monetise debt in the bid to prevent the economies and markets from imploding. Other central banks have followed while the Reserve Bank of Australia has cut rates to 0.25%. Governments have announced stimulus packages and foreshadowing tax cuts to aid small businesses and households facing national lockdowns that have brought many cities to a standstill.

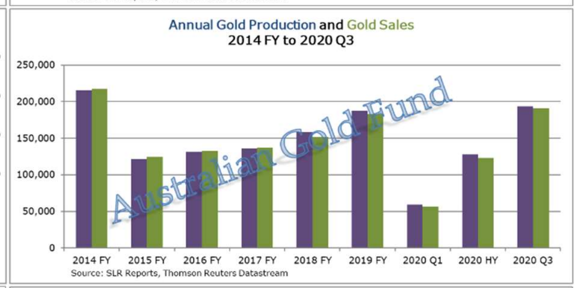
In the midst of all this, the gold price has seen a steady rise during this period with a short yet violent decline for a few days in March when it went below US$1 500/oz. However, gold demonstrated its safe haven status, laying claim to being one of very few assets that saw its price stand strong during the market-wide sell-off. The gold price started the year at US$1 520/oz and traded during this period in the US$1 460-$1 780/oz range. In Australian dollar terms, gold has broken out on the upside, starting the year at A$2 163/oz and peaking at over A$2 800/oz as the Australian dollar dipped to as low as US$0.56. It currently trades at A$2 570/oz with the Australian dollar returning to US$0.68.

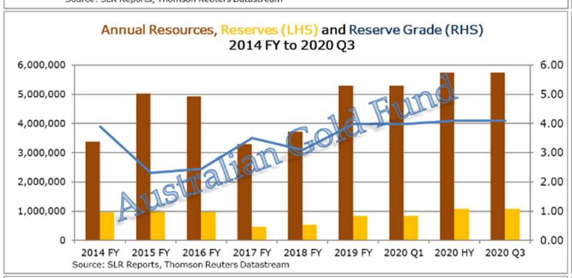
The oil price has also seen a historic crash from US$64/bbl in early January in the wake of the drone strike by the US that killed the Iranian Revolutionary Guard Commander Qassim Soleimani to US$16.60/bbl in late March in the aftermath of OPEC facing potential breakdown after negotiations between Saudi Arabia and Russia on production targets failed on 6th March. However, the spot price for WTI crude oil went outdid its decline and fell to -$37.63/bbl on 20th April, an unprecedented and inconceivable event (imagine at one stage a pack of toilet paper is cheaper than a barrel of oil, go figure!). The gold-oil ratio exceeded 100 but has since returned to 40, which is nonetheless highly accommodative for mining companies that consume substantial amounts of fuel. With many countries beginning to relax their lockdown restrictions from this point on, we expect economic recovery to be gradual but demand will likely to be slow for some time. This could lead to the demand for oil to continue to be tepid and the oil price to remain low. This should provide substantial tailwinds for mining companies and industries that are still running given input costs should be lower for a short while.

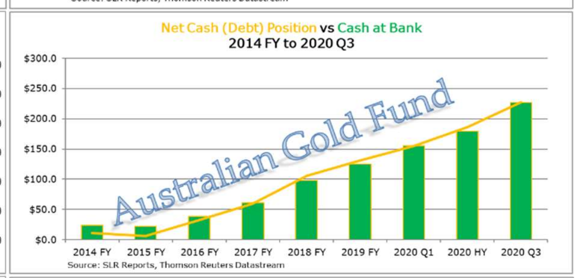
Operational and Financial Performance Charts

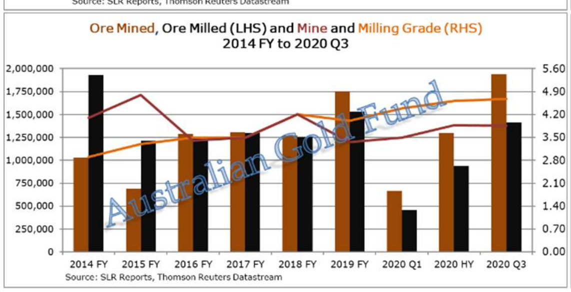


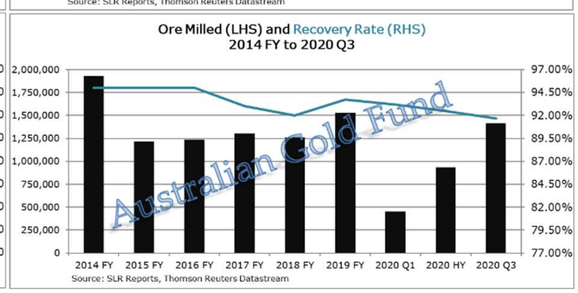








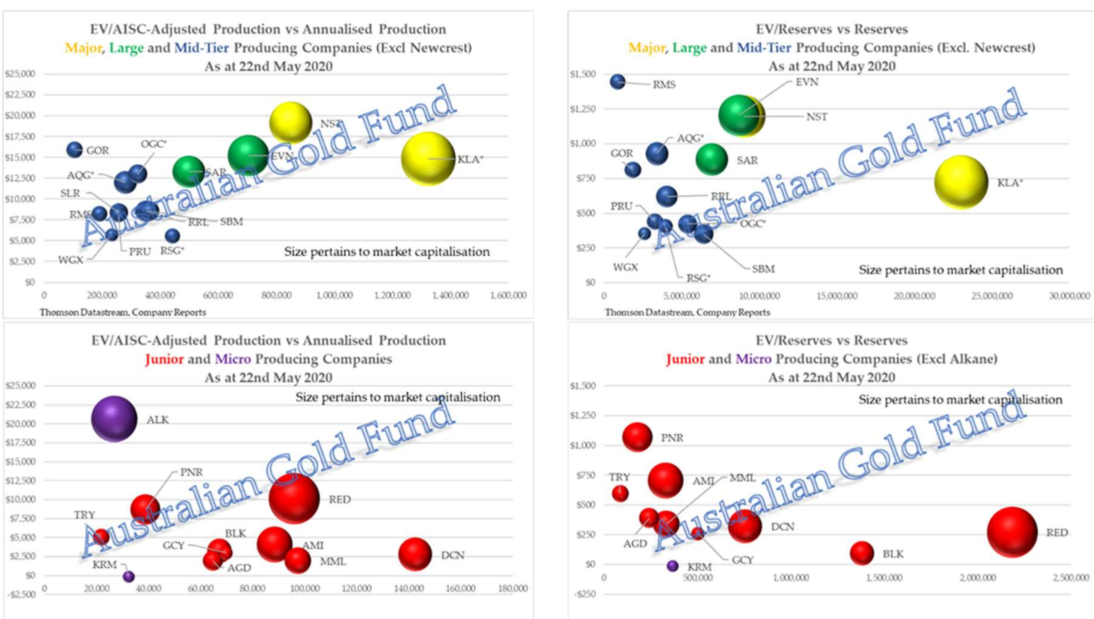




SWOT Analysis

Strengths	**Weaknesses**
• Strong track record of outperforming against its production guidance, with clear trend in delivering low-cost gold in the past year. • Substantial cash balance to support its pipeline of developments that appears to support production growth and opportunities for further expansion.	• Current reserve levels imply short mine life, although their exploration campaigns have been successful and appear to suggest reserves and resources upgrade for the next report. • Operations are relatively small scale for a mid-tier producer.
Opportunities	**Threats**
• Expansion in their production and scope of operations via acquisitions and development of the Rothsay deposit may justify future re-rating of the stock price. • Processing plant expansion at Deflector could increase production and cashflow generation. • Conversion of resources to reserves through further drilling will increase mine life.	• Any disappointments on exploration campaigns or downgrade of existing reserves or resources will threaten investor confidence on the longevity of the company's operations.

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 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*

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.

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 Silver Lake 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.