Australian Gold Fund Valuation and SWOT Analysis

Westgold Resources Limited (ASX: WGX)

Date	30/08/2019
Classification	Mid-Tier Gold Miner
Current Price	$2.340
No. Issued Stocks (m)	389.2
Net Cash + Bullion + 0.5 x GIC ($ m)	$11.87
Last Dividend Payment ($ p.a.)	$0.00
Market Capitalisation ($ m)	$910.62
Enterprise Value ($ m)	$898.75
Resources (oz)	9,344,000
Reserves (oz)	2,649,000

Ranking	**Fair Value**
Price Range	$1.52-$2.85
2020 Annual Gold Production Guidance (oz p.a.)	275 000-300 000
2020 All-In Sustaining Cost Guidance ($/oz)	$1 370-$1 420
EV/AISC-Adjusted Production Guidance ($/oz)	$4,360.00
EV/AISC-Adjusted Production Range ($/oz)	$3 000-$5 000
EV/Resources ($/oz)	$96.18
EV/Reserves ($/oz)	$339.28

Summary

Westgold Resources released their full-year results on 27th August 2019. The company has seen its stock price rise dramatically since the start of the year when it traded at $0.88. While the gold price surge since late May played a part, the company's stock price rally has been more pronounced than its peers. Part of this came about from the March quarter release when the company reported that their AISC was down to $1 269/oz, a level not seen by the company since the September 2017 quarter. The company has come out of their substantial capital development stage, having spent over $250m in mine development at Big Bell and Fortnum. They also have been relatively quiet about their mine automation, which is now in place and will be expected to deliver more efficient production with longer operating hours.

The company reported producing 255 221oz of gold over the year at AISC of $1 408/oz across their four operations – Meekatharra (94 280oz at AISC of $1 451/oz), Cue (68 255oz at AISC of $1 449/oz), Fortnum (58 308oz at AISC of $1 224/oz) and their recently divested Higginsville (34 378oz at AISC of $1 520/oz) mines. This result implies the company did underperform against their guidance of around 300 000-320 000oz at AISC $1 300-$1 350/oz for the year as they had foreshadowed last year. However, the justification is that the company has merely delayed this to 2020. The Big Bell mine in the Cue mine has been dewatered and ore has been extracted and processed. By the second half of the 2019 calendar year, the Big Bell mine is expected to ramp up further to produce up to 100 000oz p.a. For the year, the company spent over $430/oz of development capital, amounting to almost $110m, much of which went to the Big Bell mine.

Part of Westgold's inconsistent performance over the three years since it has listed separately has been in the mining operations facing either weather-related delays or access to ore bodies. The good news is that these problems have largely been put behind them, as can be seen with the progress with Fortnum that is now delivering higher grade ore and lower cost, and more recently with the Meekatharra and Cue mines. Furthermore, the company is accessing more underground ore and that is expected to deliver higher grades. The milling recovery rates are also improving, which may further provide lower cost ounces going forward. The company currently has around 4Mt p.a. ore processing capacity and ore grade of around 2.21g/t. These are expected to increase as the Big Bell mine ramps up and the company extracts more underground ore.

The management of Westgold has adopted a highly disciplined strategy of divesting their non-core and underperforming assets, including selling their Higginsville gold mine, lithium royalties and they are expected to spin-off a separate base metals exploration entity, the Rover project in the coming months. All these have allowed Westgold to replenish their cash reserves, which have gradually been declining during this development phase. These cash reserves will strengthen the company's ability to undertake further development as well as identify potential acquisitions. The company has finally returned to a net cash position of $5m through the divestment of their non-core assets.

The coming months spell an exciting time for Westgold given that they have laid their groundwork and done the hard yards of capital development and becoming a leaner and more focused mining company. With a cash balance that will increase and tailwinds of higher gold price and improved operating efficiency, the company may well deliver 300 000oz for 2020 and exceed their AISC target range of $1 370-$1 420/oz. Given these, we recommend an upgrade of the EV/AISC-Adjusted Production range to reflect their improved operational efficiency as well as a strong gold-oil ratio that will further enhance their ability to generate free cashflows.

At the current price of $2.34, the company is currently trading around the upper end of fair value, but not quite in the region of being overvalued. This takes into account the company appearing to establish themselves as a mid-tier producing company with medium cost. However, given the sharp rally in the recent month, one may not need to rush into buying as there may be some profit takers waiting in the wings.

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.

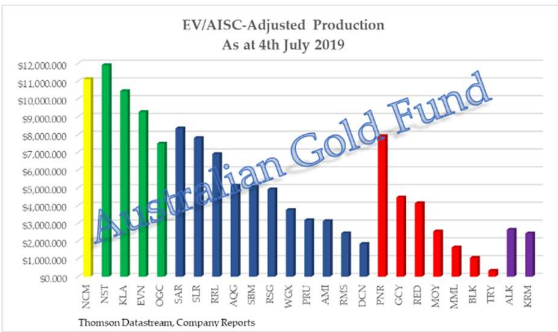
The oil price has been trading between US$50-$65/bbl on the backdrop of rising Middle East tension with Iran being in the spotlight. The US-Iran tension in the Persian Gulf and Strait of Hormuz briefly attracted much media attention and pushed the oil price above the US$60/bbl mark. This has now since 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.

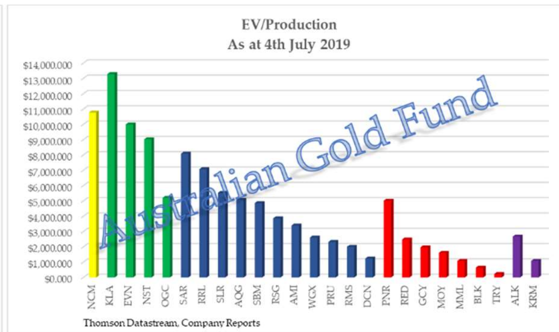
Operational and Financial Performance Charts

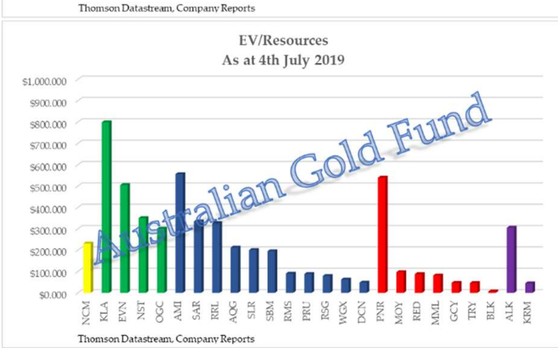
SWOT Analysis

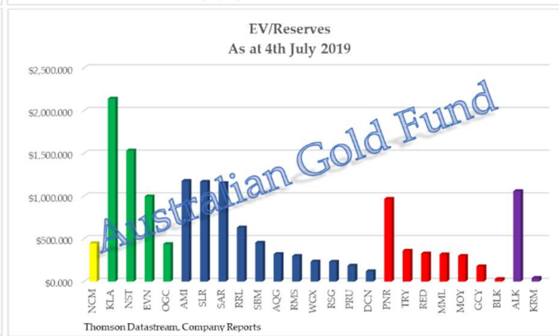
Strengths	**Weaknesses**
• Undervalued mid-tier producing company that has passed its consolidation stage and is on track to deliver lower cost ounces. • Diversified operations across three mine operations. • Management has positioned the company to focus on its core assets.	• Track record has left investors in doubt. • Stock is less liquid as investors have not paid too much attention to them compared to its peers owing to past underperformance. • Transparency can be improved given the quarterly reports omit critical information regarding debt, only disclosing these in the half-year and full-year results.
Opportunities	**Threats**
• Potential to acquire late-stage exploration and early-stage development companies to replenish reserves and resources to expand mine life. • Substantial underground development opportunities to exploit in their existing mines.	• May be a takeover target. • Further operational difficulties with their mines leading to poor cashflow generation.

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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