

Test looms for gold as investors cash out



DURING the past few months, gold has been about the only game in town where investors have been able to make money as stocks rise. Some stocks, such as Catalpa and Oceanagold, have more than tripled this year. The current 'third wave' downward being experienced by global stock markets will test the gold market during March, as stressed investors sell anything they can get their hands on to raise cash, including physical gold and certainly gold equities.

In the past, *Briefcase* ranked gold companies on the basis of their market capitalisation per ounce of gold resources. This is useful to determine which companies have the largest upside potential. The problem with this method is that some companies, such as St Barbara and Oceanagold, have large amounts of gold in resources but much of this mineralisation would not be converted into commercial reserves until the gold price doubles from its current level and after much more work is undertaken to confirm the mineralisation in place.

Looking at market value per ounce of gold in mineable reserves gives a more conservative ranking, but companies with no official reserves, such as Azumah, miss out under this classification.

Briefcase has taken analyst's licence to estimate reserves in some cases, which are thus, not Joint Ore Reserves Committee (JORC) compliant. For example, recent project acquisition and drilling looks set to move Azumah's 754,000 ounces of gold in resources towards 1 million ounces. Given the grade and geometry of this mineralisation, *Briefcase* estimates that about 70 per cent of that gold will find its way into mineable reserves.

Similarly, Focus has just 223,000 ounces of gold in reserves, out of a resource estimate totalling 1.9

million ounces. Given the grade and location of much of this mineralisation, adjacent to existing underground mining facilities and along strike from previous open pit mining, *Briefcase* has boosted Focus's reserve estimate to 445,000 ounces, but expects that at least 1 million ounces of gold will eventually be mineable under current gold price conditions.

Based on gold reserves, Dominion and Ramelius look expensive, because they are yet to add large volumes of gold in the reserves category. Dominion, like many of its peers, manages to keep three to four years of ore in reserves as it explores and converts resources into reserves. Ramelius trades on faith. Investors have seen spectacular, multi-ounce drill intersections and are hoping that this mineralisation continues to the centre of the earth.

Only further drilling will establish the extent of Ramelius' mineralisation, but the company has a small processing plant and can use operating cash surpluses to continually establish mining targets by low-cost drilling from underground workings. This may not satisfy the purists, but the company may be able to bootstrap mine development and continue regional exploration. This comparison based on the reserves category of gold, needs to be treated with care.

Another factor is the cost of gold production. Dominion and Newcrest are very low-cost miners, so their profitability per ounce is high, while St Barbara and Resolute are high-cost operators, attracting a lower rating than their low cost peers.

When *Briefcase* worked in London during the late 1980s and early 1990s, Julian Baring ran a 'Gold and General' fund, which eventually became the largest resources fund in the world. Julian was a methodical investor, who established a method

of assessing gold companies based on their estimated amount of gold in reserves and estimated costs associated with extracting that gold.

The technique worked wonderfully well, with many of his gold company selections increasing in value by 10-fold and even the laggards rose by a factor of seven times during the early 1990s

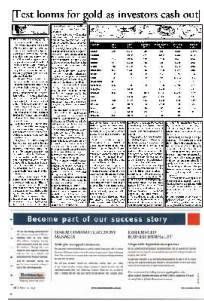
Briefcase has tried to emulate the late Julian Baring by comparing the estimated value of gold reserves with current market capitalisation.

Firstly, gold in reserves is either extracted from company reports, or in the case of Azumah, Focus, Integra and Alkane, it has been estimated on a conservative basis. For instance, Integra has established gold Resources of 1.8 million ounces, largely consisting of shallow, high-grade mineralisation, which will eventually prove to be commercial. *Briefcase* has classified just 520,000 ounces as reserves for this exercise.

Next a recovery factor is applied to the whole reserve. Tianshan has a large, low-grade project in China, where it proposes a heap leach operation, recovering 57 per cent of contained gold, whereas Catalpa is estimating that it will recover about 91 per cent of gold from its low grade project at Westonia in WA.

Today's gold price is applied to the total recovered gold to determine revenue and then royalties are deducted from this amount to determine net revenue. *Briefcase* has estimated capital and operating costs associated with mining the total gold reserves. Known capital projects are factored in while an ongoing capital charge is levied, depending on the type of mining.

For instance, underground miner Beaconsfield is estimated to have cash operating costs of \$A700/oz, while capital costs of \$A165/oz



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are levied to account for ongoing mine development. Open-pit mines generally attract capital charges of between \$A45 and \$A85/oz of production.

Unfunded capital costs have been inflated by 15 per cent to account for funding charges. *Briefcase* has subtracted or added the value of any hedges held by the company and adds this net amount to the company's net cash/debt position, including convertible notes as debt, to achieve a pre-tax cash generation figure. Tax is deducted from this net amount at a uniform 30 per cent and the estimated value of any other significant assets is added to the net amount. Perseus has share investments, Oceanagold has \$20

million added for its Philippines gold and copper project, Newcrest has a nominal \$200 million added for its copper content while Alkane is given \$80 million of extra value for its Zirconium/Rare Earths Project.

This undiscounted gold value is then divided by the total number of shares and options in the company, without accounting for any additional capital that might be subscribed by the conversion of options, to determine a target value per share, which is then compared with today's share price.

It can be argued that gold is a special metal, whose price rises over time in line with economic growth, so no discount of cash flows is required to determine fair value.

The table above ranks stocks on the basis of the premium ascribed to their value by this method, compared with their current share price. Gold development companies will require additional equity, diluting value per share estimates, but *Briefcase* adjusts for this by loading capital costs by 15 per cent.

The most attractive companies on this basis include Azumah, Tianshan, Catalpa, Perseus and Alkane, while Apex, Ramelius and Dominion are seen as being overvalued at share prices listed above.

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Company	ASX Code	price \$/shr	Resources '000 oz	Mining Reserve '000 oz	Target Value \$/share	premium to price %
Azumah	AZM	\$0.083	754	528	\$1.12	1254%
Tianshan	TGF	\$0.09	2640	1,032	\$0.63	627%
Perseus	PRU	\$0.56	5700	2,400	\$3.71	563%
Catalpa	CAH	\$0.085	1469	738	\$0.39	363%
Alkane	ALK	\$0.185	660	350	\$0.85	359%
Oceanagold	OGC	\$0.790	3480	2,400	\$2.52	219%
Integra	IGR	\$0.195	1800	520	\$0.46	134%
Focus	FML	\$0.025	1800	445	\$0.053	111%
Beaconsfield	BCD	\$0.160	416	265	\$0.22	37%
St Barbara	SBM	\$0.395	8300	2,300	\$0.49	25%
Kingsgate	KCN	\$4.60	3570	1,400	\$5.57	21%
Newcrest	NCM	\$31.00	71000	40,000	\$34.72	12%
Lihir	LGL	\$3.00	41300	22,100	\$3.34	11%
Avoca	AVO	\$1.72	1440	1,450	\$1.90	11%
Resolute	RSG	\$0.59	6000	2,500	\$0.60	2%
Apex	AXM	\$0.27	3400	548	\$0.24	-10%
Dominion	DOM	\$4.90	722	630	\$3.13	-36%
Ramelius	RMS	\$0.59	84	80	\$0.19	-67%