

Mining Flash Note

Scotgold Resources*

SGZ LN

BUY

TP 84p (up from 57p)

03 September 2019

Stock Data

Ticker	SGZ LN
Share Price:	35p
Market Cap:	£17.1m
	\$20.5m

Price Chart



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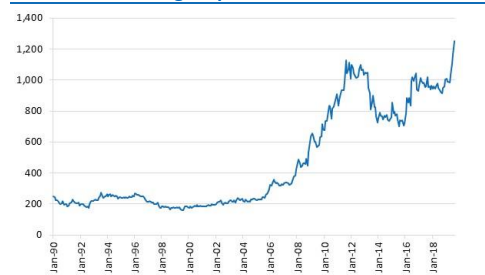
First production in sight as GBP gold price hits all-time high

Scotgold Resources is an AIM listed gold development company with the wholly owned flagship high grade Cononish gold project in Scotland. The deposit hosts 198koz gold at 11.1g/t in mineral reserves and 266koz gold at 13.4g/t in total mineral resources, based on the latest BFS (Feb/17). Located in an environmentally sensitive region of the Loch Lomond and Trossachs National Park, the team has established a good working relationship with the Park Board, adjusting project parameters to the status of the area including no use of cyanide in the on-site processing of mined ores, opting instead to use gravity separation and flotation, as well as dry stack tailings storage designed to replicate the glacial landscape of the area. The Park Board unanimously voted in favour of granting the mining permit with development works launched in Dec/18 with first gold targeted by Q1/20.

The team is implementing a phased development strategy starting off at 36ktpa processing rate (14kozpa) before ramping up to 72ktpa (22kozpa) in ~30m post first production according to the BFS. The project is fully funded with £4m in cash as of Dec/18 as well as £7.5m in a standby loan facility. Doubling of the capacity of the plant as part of Phase II is expected to be funded through internal cash flows. Cononish TCC are estimated to average c.\$550/oz (c.£390/oz at 1.4\$/£ exchange rate) allowing it to earn above industry average EBITDA margins over the course of its current 9y life of mine. At full capacity the project is estimated to generate £14m in EBITDA per annum and £12m in FCF (£11m including corporate admin costs) assuming 22kozpa at \$1,455/oz gold price and 1.4\$/£ exchange rate.

- The Company has recently released a project update touching on the progress of construction works at the high grade Cononish project as well as updating capital cost estimates and first production guidance.
- First production target slipped slightly and is now expected in the end of Feb/20 versus originally guided Dec/19 on the back of civil engineering design delays.
- Earthworks are due to commence in September, four months behind the targeted May start, as the characteristics of the area (elevation, environmental conditions, geotechnical factors) required more design work.
- Mine development is continuing with ore access to be completed by end of 2019 as scheduled.
- Major processing plant parts sourced from South Africa and China are currently in transit and should be arriving on site in due course.
- Life of mine capital cost has been revised from £20m estimated in the Mar/17 BFS to £27m.
- Operating costs have come up only slightly to £398/oz v £373/oz estimated previously as higher power costs assumed have been partly compensated by lower operating expenses related to tailings management; also, we suspect higher cash costs reflect higher royalty expense due to stronger gold prices assumed (Company used £1,200/oz gold price in update project economics study v £920/oz in the Mar/17 BFS).
- Updated costs called for an additional £2.5m capital injection that is being funded through a combination of equity and debt.

GBP denominated gold price



Source: Bloomberg

- Natl le Roux agreed to extend the existing loan facility by £1.5m taking the total to £7.5m; additionally, the Company is issuing 3.3m new shares at 35p for £1.15m of gross proceeds (more than 80% of the equity raise is being provided by three Company Directors and a member of the management team)
- The term of the loan has also been extended to 36 months (from 24 months) from each drawdown.
- On the positive note, the Company updated BFS economic study reflecting the latest strong run in gold prices. This more than compensated for higher costs with life of mine EBITDA up ~45% at £146.7m at £1,200/oz gold price (\$1,500/oz) compared to previously assumed £920/oz (\$1,150/oz at 1.25 exchange rate used in the BFS). This brings a ~46% increase in NPV10% (pre-tax) to £63.3m.

Conclusion: As much as an increase in capital costs and a delay to first production that led to a debt and equity capital injection by investors is an unwelcome setback, the Scotgold investment case remains strong with the high grade Cononish project continuing to offer strong cash margins (SPA TCC estimate of £386/oz v current ~£1,270/oz spot gold price). Furthermore, as previously highlighted, the team has brought forward a fair share of the Phase 2 capex which in turn helps to de-risk and potentially accelerate the future switch to Phase 2. We assumed first gold from Phase 2 in H1/22 v H2/22 as per BFS timing.

The Company benefits from weak British pound amid fears over no-deal Brexit and strong gold prices driven by a revision to investors' expectations of future growth prospects as well as geopolitical risks including rising tensions in Hong Kong and the dissolution of the Italian government.

We have included expanded capex and increased number of shares reflecting the latest equity raise (48.9m) as well as increased our gold price assumptions (\$1,455/oz v \$1,350/oz) and slightly adjusted USD/GBP rate down for 2020 (1.3 v 1.4 previously; although, kept it at conservative 1.4 from 2021 onwards, offering further upside to the valuation should the pound underperform our assumptions). All in all, we have revised our target price to 84p (up from 57p) and reiterated our buy recommendation highlighting the attractive investment case of the Company that is coming into production at the time when GBP denominated gold prices trade at record high (see chart on the left).

(Jun year end)		FY18	FY19e	FY20e	FY21e	FY22e
Gold price	US\$/oz	1,298	1,261	1,444	1,455	1,455
Gold price	GBP/oz	964	974	1,133	1,078	1,039
AUDGBP	A\$/£	1.74	1.81	1.80	1.80	1.80
Gold sales	koz	-	-	3.6	16.4	18.4
TCC	GBP/oz	-	-	482	358	344
Sales	A\$m	0.3	-	7.3	31.8	34.3
EBITDA	A\$m	-1.7	-2.7	2.8	19.9	21.6
PAT	A\$m	-1.9	-2.9	1.1	14.7	12.2
Basic EPS	A\$/c	-7.9	-6.5	2.2	30.0	24.9
FCF	A\$m	-2.0	-13.6	-11.1	9.6	15.3
EV/EBITDA	x	-	-	12.5	1.8	1.6
PER	x	-	-	30.9	2.2	2.7

Prices as of 30/08/19 (37p)

Source: SP Angel, Company

SP Angel Earnings Summary

A\$m unless stated (YE Jun)

Market data			Operating metrics						
			FY17	FY18	FY19e	FY20e	FY21e		
Ticker		SGZ LN	USDGBP	1.27	1.35	1.29	1.28	1.35	
Last price	GBP	37	AUDGBP	1.68	1.74	1.81	1.80	1.80	
Target price	GBP	84	Gold price spot	US\$/oz	1,258	1,298	1,261	1,444	1,455
Rec		BUY	Gold price spot	GBP/oz	992	964	974	1,133	1,078
GBPUSD		1.22	GE sales	koz	-	-	-	4	16
AUDUSD		1.48	TCC	GBP/oz	-	-	-	482	358
Mkt cap	GBPm	18.0	AISC	GBP/oz	-	-	-	605	413
	USDm	22.0	Income Statement						
EV	GBPm	19.4	Revenues	0.0	0.3	-	7.3	31.8	
	USDm	23.7	EBITDA	-1.1	-1.7	-2.7	2.8	19.9	
Av # of sh in issue	mln	48.9	margin	-	-	-	39%	63%	
Av # traded, 100d	mln	0.01	EBIT	-1.2	-1.7	-2.8	2.1	15.9	
Prices 30/08/19			Net Interest	-0.1	-0.2	-0.1	-1.0	-1.2	
			PBT	-1.3	-1.9	-2.9	1.1	14.7	
			Tax	-	-	-	-	-	
			PAT	-1.3	-1.9	-2.9	1.1	14.7	
			EPS basic, cents	-8.6	-7.9	-6.5	2.2	30.0	
			EPS diluted, cents	-8.6	-7.9	-6.5	2.2	30.0	
			Cash flow						
			CFO (post WC)	-1.4	-1.7	-3.9	4.4	20.0	
			Interest paid	-0.0	-	0.1	1.0	1.2	
			Tax paid	-	-	-	-	-	
			Net CFO	-1.4	-1.7	-3.9	4.4	20.0	
			Capex (incl Exploration)	-0.8	-0.3	-9.7	-15.4	-10.4	
			CFI	-0.8	-0.3	-9.7	-15.4	-10.4	
			Issue of shares	0.9	12.6	1.4	2.0	-	
			Proceeds from borrowings	1.2	-	3.7	10.9	1.2	
			Repayment of borrowings	-	-	-1.8	-	-	
			CFF	2.0	12.5	3.3	12.9	1.2	
			Net cash flow	-0.1	10.5	-10.2	1.8	10.8	
			Cash cf	0.6	11.2	1.1	3.0	13.8	
			Balance Sheet						
			Cash	0.6	11.2	1.1	3.0	13.8	
			Receivables/prepayments	0.0	0.1	0.1	0.6	2.6	
			Inventories	0.2	0.1	0.8	0.3	1.2	
			Current assets	0.9	11.4	2.0	3.9	17.6	
			Exploration and PPE	16.6	16.9	25.8	40.0	46.4	
			Non-current assets	16.7	17.0	27.3	41.6	48.0	
			Total assets	17.6	28.4	29.4	45.5	65.6	
			Payables/provisions	0.2	0.3	0.0	0.6	2.4	
			Borrowings ST	1.7	1.7	-	-	4.4	
			Current liabilities	2.0	2.1	0.1	0.7	6.8	
			Borrowings LT	-	-	3.7	14.6	12.8	
			Non-current liabilities	-	-	3.7	14.6	12.8	
			Total liabilities	2.0	2.1	3.8	15.3	19.7	
			Net assets	15.6	26.3	25.5	30.2	45.9	
			Key financial metrics						
			Net debt/(cash)	A\$m	1.2	-9.5	2.6	11.7	3.5
			Av # of sh (diluted)	mln	15.7	25.9	45.0	48.9	48.9
			EV/EBITDA	x	-	-	-	12.5	1.8
			PER	x	-	-	-	30.9	2.2
			FCF (CFO-Capex)	A\$m	-2	-2	-14	-11	10
			ROE	%	-	-	-	3.8%	38.6%
			Assets/Equity	x	1.1	1.1	1.1	1.5	1.4
			P/BV	x	1.0	0.7	1.0	1.2	0.9
			Net Debt/EBITDA	x	-	-	-	4.1	0.2

Source: SP Angel

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