

27 April 2020

#### Stock Data

Ticker	SGZ LN
Share Price:	49p
Market Cap:	£25m
	\$31m

#### Price Chart



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## Delivering production at Cononish

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 (23kozpa) in ~30m post first production according to the BFS. Cononish TCC are estimated to average c.\$510/oz (c.£390/oz at 1.3\$/£ 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 £19m in EBITDA per annum and £16m in FCF (£15m including corporate admin costs) assuming 23kozpa at \$1,600/oz long term gold price and 1.3\$/£ exchange rate.

- The high grade Cononish gold project is expected to come online this year offering investors exposure to rising gold prices amid increased investment demand, heightened volatility in financial market and downgraded economic growth forecasts seeing monetary and fiscal authorities embarking on unprecedented stimulus measures.
- On project development status, the Company reported the arrival of all seaborne equipment parts in Oct/19 and an engagement of a local construction firm to build a dedicated plant building and tailings management facility in Sep/19.
- Development works encountered delays due to changes in construction scheduling as the team altered the site layout to accommodate environmentally sensitive peat areas and heavy rainfalls recorded earlier this year exceeded planned allowances. The team identified and had approved a new peat cell layout, and decided to downscale the earthmoving machinery, making it less sensitive to wet conditions but in turn that has meant a delay to the Cononish commissioning.
- In March, in line with the Scottish government's coronavirus guidance, all underground work and all non-essential surface work was placed on hold. Around half the total workforce has been furloughed to keep running costs down (~\$0.1m per month). Operations are ready to restart once the lockdown is lifted, with the site kept on care and maintenance for now.
- In the latest operations update, the Company highlighted mobilisation risks and uncertainty over how fast contractors can restart construction and plant assembly works.
- In our updated earnings and cash flow estimates, we adjusted the start of operations to H2/20 with a slow ramp up processing <10kt through to the end of the year, compared to 36ktpa full Phase I capacity.
- On available liquidity, the Company had A\$4.6m (~£2.4m) in cash as of YE19 and £3.5m remaining undrawn under the £7.5m secured loan facility provided by Nat le Roux, its major shareholder (44%).

- As temporary lockdown remains in place and the timing of commissioning is uncertain, the Company may run into a liquidity gap. While we expect the current quarantine to be relatively shortlived, we argue that the shortfall is likely to be limited and attractive economics of the project with favourable precious metals environment can carry more leverage that may be utilised to close the gap.
- Using \$1,600/oz gold price and 1.3 GBPUSD exchange rate, the project at full 72ktpa and 23kozpa capacity yields £19m EBITDA and £16m FCF (excluding corporate expenses), implying strong earnings margins (~65% project EBITDA margin) that the Company can potentially leverage off if required. Additionally, high grade nature of the deposit and easy metallurgy means the project remains economical at weaker gold prices as well.

**Conclusion:** We maintain our buy recommendation on the Company having revised our gold price (\$1,600/oz from the start of CY21 onwards compared to \$1,455/oz use previously), exchange rate (1.3 USDGBP rate v 1.4 before) and discount rate (8%, down from 10%) assumptions as well as pushing out the Cononish commissioning to Q4/20 adjusting for the lockdown related delays. Target valuation and NAVPS increase to £63m and 119p, respectively. We attach a sensitivity table for NAVPS versus different gold price and USDGBP exchange rate assumptions (all using 8% discount rate).

**NAVPS sensitivity to changes in gold price and exchange rate (DR 8%) – SPA base case highlighted**

		Gold price					
		1,200	1,250	1,300	1,500	1,600	1,700
USDGBP rate	1.20	81	88	95	122	136	150
	1.30	69	75	81	106	119	132
	1.40	57	63	69	93	104	116
	1.50	48	53	59	81	92	103
	1.60	39	45	50	70	81	91

Source: SP Angel

(Jun year end)		FY18	FY19	FY20e	FY21e	FY22e
Gold price	US\$/oz	1,298	1,261	1,564	1,627	1,600
Gold price	GBP/oz	964	974	1,222	1,251	1,231
AUDGBP	A\$/£	1.74	1.81	1.87	1.90	1.90
<b>Gold sales</b>	koz	-	-	-	<b>6.9</b>	<b>16.3</b>
<b>TCC</b>	GBP/oz	-	-	-	<b>520</b>	<b>371</b>
<b>Sales</b>	A\$m	-	-	-	<b>16.3</b>	<b>38.0</b>
<b>EBITDA</b>	A\$m	<b>-1.9</b>	<b>-3.1</b>	<b>-1.6</b>	<b>7.6</b>	<b>24.7</b>
PAT	A\$m	-1.9	-3.5	-2.7	4.8	18.1
Basic EPS	A\$c	-7.9	-7.8	-5.3	9.4	35.2
<b>FCF</b>	A\$m	<b>-2.0</b>	<b>-9.9</b>	<b>-19.1</b>	<b>4.8</b>	<b>8.9</b>
<b>EV/EBITDA</b>	x	-	-	-	<b>7.0</b>	<b>2.2</b>
PER	x	-	-	-	10.2	2.7

Prices as of 22/04/20 (49p)

Source: SP Angel, Company

## SP Angel Earnings Summary

A\$m unless stated (YE Jun)

Market data			Operating metrics					
			FY18	FY19	FY20e	FY21e	FY22e	
Ticker		SGZ LN	USDGBP	1.35	1.29	1.28	1.30	1.30
Last price	GBP	49	AUDGBP	1.74	1.81	1.87	1.90	1.90
Target price	GBP	119	Gold price spot	US\$/oz	1,298	1,261	1,564	1,627
Rec		BUY	Gold price spot	GBP/oz	964	974	1,222	1,251
GBPUSD		1.23	GE sales	koz	-	-	7	16
AUDUSD		1.59	TCC	GBP/oz	-	-	520	371
Mkt cap	GBPm	25.2	AISC	GBP/oz	-	-	650	426
	USDm	30.9	Income Statement					
EV	GBPm	27.6	Revenues	-	-	-	16.3	38.0
	USDm	33.9	EBITDA	-1.9	-3.1	-1.6	7.6	24.7
Av # of sh in issue	mln	51.4	margin	-	-	-	47%	65%
Av # traded, 100d	mln	0.03	EBIT	-2.0	-3.4	-2.0	6.1	19.9
Prices 22/04/20			Net Interest	0.1	-0.1	-0.7	-1.3	-1.2
			PBT	-1.9	-3.5	-2.7	4.8	18.7
			Tax	-	-	-	-	-0.7
			PAT	-1.9	-3.5	-2.7	4.8	18.1
			EPS basic, cents	-7.9	-7.8	-5.3	9.4	35.2
			EPS diluted, cents	-7.9	-7.8	-5.3	9.2	34.4
			Cash flow					
			CFO (post WC)	-1.7	-3.1	-1.7	6.5	22.9
			Interest paid	-	-	-	-	-
			Tax paid	-	-	-	-	-0.7
			Net CFO	-1.7	-3.1	-1.7	6.5	22.9
			Capex (incl Exploration)	-0.3	-6.8	-17.5	-1.7	-14.1
			CFI	-0.3	-8.2	-17.4	-1.7	-14.1
			Dividends	-	-	-	-	-
			Issue of shares	12.6	1.4	3.9	-	-
			Net debt proceeds / (repaid)	-	2.6	12.2	-2.4	-4.5
			CFF	12.5	4.0	16.1	-2.4	-4.5
			Net cash flow	10.5	-7.2	-3.0	2.4	4.3
			Cash cf	11.2	3.9	1.0	3.4	7.7
			Balance Sheet					
			Cash	11.2	3.9	1.0	3.4	7.7
			Receivables/prepayments	0.1	0.1	0.4	1.3	3.1
			Inventories	0.1	0.0	0.0	0.7	1.3
			Current assets	11.4	4.1	1.6	5.6	12.4
			Exploration and PPE	16.9	23.3	43.5	43.6	52.8
			Non-current assets	17.0	24.8	45.1	45.2	54.4
			Total assets	28.4	28.9	46.7	50.8	66.8
			Payables/provisions	0.3	0.6	0.9	1.4	2.7
			Borrowings ST	1.7	0.2	0.2	4.5	13.6
			Current liabilities	2.1	0.8	1.2	6.0	16.4
			Borrowings LT	-	4.2	18.0	12.5	0.1
			Non-current liabilities	-	4.5	18.0	12.5	0.1
			Total liabilities	2.1	5.3	19.2	18.5	16.4
			Net assets	26.3	23.7	27.5	32.3	50.4
			Key financial metrics					
			Net debt/(cash)	A\$m	-9.5	0.5	17.2	13.7
			Av # of sh (diluted)	mln	24.0	45.1	50.3	52.5
			EV/EBITDA	x	-	-	7.0	2.2
			PER	x	-	-	10.2	2.7
			FCF (CFO-Capex)	A\$m	-2	-10	-19	5
			ROE	%	-	-	16.1%	43.7%
			Assets/Equity	x	1.1	1.2	1.7	1.6
			P/BV	x	0.6	1.0	1.9	1.6
			Net Debt/EBITDA	x	-	-	1.8	0.2

Source: SP Angel

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