

Saracen Mineral Holdings Ltd

(SAR \$0.43) Buy

23 June 2010

- ▶ **Price Target:** \$0.56/sh
- ▶ **Reason For Update:** Capital Raising and Site visit
- ▶ **What we know:**

SAR has raised \$35m in a two tranche placement of 92m shares @ \$0.38/sh. The funds will be used as follows

- \$20m for Red October and other mine developments;
- \$5m for regional exploration including Red October;
- \$8m to retire RMB project debt;
- \$2m for working capital.

Post raising SAR will have \$32m in cash and nil debt. Importantly it will be fully funded for all its capital requirements over the next 2 yrs.

SAR has produced 19.3koz at a cash operating cost of A\$607/oz (inclusive of royalties) for the first two months of production (April and May). It has generated gross revenue of \$23.5m, implying a gold price rec'd of \$1,217/oz. This equates to an operating margin of \$610/oz.

Guidance for the June'Q remains at 25-30koz at a cash operating cost of A\$690/oz.

The reported operating costs include all royalties namely the 2.5% State Royalty and a 1.5% Gross royalty to Royal Gold. This demonstrates managements conservative approach to operations with many of its peers only reporting C1 (mine site) costs. We estimate the royalties add some \$40/oz to operating costs.

The Whirling Dervish pre-strip is complete and first ore has been delivered to the mill.

Operations are performing better than budget. Mining costs are ~ 15% below budget, Milling costs are at ~ A\$15/t vs budget of \$16.50/t and Porphyry reconciliations are 6% above feasibility, a strong turnaround from the -12% reconciliation initially experienced in Feb/Mar'10.

The Red October development has potential to increase production from ~ 110koz to 160koz with the introduction of some of this high grade underground material.

Our valuation has fallen from \$0.61/sh to \$0.56/sh through dilution, however it includes no production from Red October and 'back of the envelope' valuation suggest, if viable, Red October could add some \$0.15-\$0.20/sh to our valuation.

- ▶ **What we think:**

Carouse Dam continues to perform very well, generating significant free cashflow and demonstrating that refurbished gold assets operated by a strong management team can be successful.

The guidance of 25-30koz in the June Q is very achievable and implies production in June of a minimum of 5.7koz needs to be produced. We understand production will be slightly impacted by some crusher repairs and subsequent feeding of some low grade stockpiles, so our June month production forecast is 7.5koz for total quarterly production of ~ 27koz. We forecast operating costs will come in under guidance of \$690/oz at ~ A\$660/oz.

Our FY'11 production forecast of 113koz at an operating cost of \$673/oz is unchanged.

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It is pleasing to see the change in mining method at Porphyry has resulted in an 18% turnaround in reconciliations. This flexible mining approach has been possible due to the contract with Emeco of dry hire rates compared to a standard bcm contract rate.

The Whirling Dervish pre-strip is complete and has come in some \$1.5m below budget principally due to the significant amount of unexpected free dig material (SAR budget included drill and blast from surface). There are some nice high grade zones (22m @ 7.6 g/t Au, 28m @ 5.7 g/t Au) within the overall reserve of 4.3mt @ 1.6 g/t Au. The pit will be developed in three phases with the initial 1A pit targeting some of the higher grade zones. The overall strip ratio at Whirling Dervish is 1.2:1 now the pre-strip is complete.

The Red October asset has the potential to be a game changer for SAR. This is a high grade asset which has had no exploration/development work for 5-6 yrs. Previous open pit mining produced some 130koz from 500kt @ 7 g/t Au to a vertical depth of 90m. Drilling defined three underground resources totalling 0.76mt @ 8.4 g/t for 205koz and a feasibility study had been completed before the previous owner, Sons of Gwalia, went into administration.

SAR's has committed to a ~ \$15m-20m trial underground mining phase. This will involve;

- Dewatering;
- Trial Mining – bulk samples;
- Underground drilling.

The trial underground mining will be useful for confirming geological interpretations and underground design and a bulk sample to test the metallurgical response in the Carouse Dam plant. In addition drilling from underground will be cheaper than surface drilling from the salt lake and proper drill orientations will be available. SAR believe a bulk sample of ~ 100kt may eventually cover the bulk of the capital cost,

Red October dewatering will take 12-15 months and in the interim SAR will drill some of the geophysical targets generated to the north. Interestingly Sunrise Dam, located some 20km to the north of Red October recently discovered a multi million ounce resource below the Dolly Fault. This fault structure is present on SAR's tenement and will be a target.

If Red October proves viable it is possible to envisage production increasing to 160koz pa as ~ 200-300kt of high grade Red October ore is blended with Karari ore to produce a head grade of +2 g/t Au. Whilst Red October is ~ 120km from Carouse Dam, the cost involved in trucking this ore would equate to ~ 0.3 g/t Au – immaterial in the context of 6-8 g/t ore.

Funds will also be used for the Karari pre-strip. This should start in Nov'10 and be completed by July'11 for a total capital cost of \$20-25m. With current reserves of 223koz @ 1.4 g/t this will be the 3rd ore source for the Carouse Dam mill.

Other exploration priorities include;

- High grade extensions beneath the Whirling Dervish and Karari open pits with no drilling beneath 400m
- Porphyry District both underground targets and more regional targets at Million Dollar, Enterprise and Wallbrook
- Safari Bore District including down dip extensions at Deep South.

The proposed RSPT does impact SAR as the sunk capital to re-start Carouse Dam was only \$25m, lowering the RSPT capital allowance available plus it only pays a 2.5% gold state royalty. On the positive SAR has \$55m in tax losses that can be utilised. The net impact is our valuation falls by \$0.04/sh or 7%.

► **Investment Case:**

SAR is a cheap domestic gold producer. An enterprise value of \$160m for a 110-120koz gold producer generating operating margins of +\$600/oz for at least 7-8 yrs is compelling. It has been significantly de-risked with operations now strongly cashflow positive and a 2nd ore source at Whirling Dervish now available in close proximity to the mill.

With commissioning now complete the focus is moving to target higher grade ore sources with a view to increasing production through blending and lowering costs. The capital initiatives are all well thought out sensible options and we are excited with the potential of Red October to deliver some high grade ounces. Ultimately we see real potential for mine life of +10yrs to be defined.

There remains many areas that are underexplored with some areas previously tied up in Native Title disputes for the past 10yrs and little modern exploration over the past 5 yrs. SAR has a budget of +\$10m for both regional and near mine exploration in FY'11.

SAR trades on EV/reserve and EV/resource oz of \$192/oz and \$55/oz respectively. This is a ~50% discount to its peer group and believe this discount is unwarranted. It is more reflective of the cynicism regarding old gold assets than actual performance to date and expect, as production targets are achieved, this discrepancy will reduce.

Our valuation has fallen from \$0.61/sh to \$0.56/sh due to the dilution from the equity raising. We currently do not model in any production from Red October and at this stage forecast a relatively flat production profile of 100-120koz pa – clearly there is upside if Red October and/or one of the other exploration targets develops. SAR remains a relatively untold story with management focussed on successfully re-starting Carouse Dam rather than promotion.

SAR is cashed up mid cap gold producer which is now fully funded for all its growth initiatives over the medium term. It is undervalued based on its current 7-8yr reserve life and offers real upside through development of Red October and an aggressive exploration program to commence shortly.

Euroz Securities declares that it has acted as underwriter to and/or arranged an equity issue in and/or provided corporate advice to Saracen Mineral Holdings Ltd during the last year. Euroz Securities has received a fee for these services.

SARACEN MINERAL HOLDINGS LTD (SAR)		YEAR END 30 JUNE				
MARKET STATISTICS						
Share Price	\$0.43 A\$/sh	Directors				
Issued Capital		G. Staltari	Ex Chair'n			
FP Ord	491.2m*	I. Hoffman	Dir			
Opt (@\$0.20/sh 15/11/09)	19.6m	B.Parker	Dir			
Total Dil. FPOrd	408.5m	C.Thompson	Dir			
Market Capitalisation	\$213m	Shareholders				
Enterprise Value	\$180m	Dir + Mgt		9%		
Debt	\$-m	Clodene		9%		
Cash	\$33m	Baker Steel		8%		
Hedging	161koz puts bought @ A\$1250/oz, 95 calls sold A\$1,250/oz					
* assumes issue of 92m @ \$0.38/sh						
ASSET VALUATION		A\$m	A\$/sh			
Sth Laverton Gold project		238	0.47			
RSPT (risk adj)		(23)	(0.05)			
Corporate		(19)	(0.04)			
Expl'n (rem rsc @ \$20/oz)		30	0.06			
Tax Losses		17	0.03			
Unpaid Capital		3	0.01			
Debt (post placement)		-	-			
Cash (post placement)		33	0.07			
Total @ 10% real		279	0.56			
If RSPT adopted or abandoned, impact on valuation respectively:						
if RSPT (unrisked)		257	0.51			
if RSPT (excluded)		302	0.60			
F/CAST PRODUCTION (A\$m)		2010f	2011f	2012f	2013f	2014f
Attrib. Prod'n (koz)						
Carouse Dam		41	113	107	104	105
Total Attrib (koz)		41	113	107	104	105
Prices (A\$/oz)						
Avg Spot Gold Price		1,117	1,342	1,369	1,446	1,475
Avg Gold Price Rec'd		1,265	1,296	1,339	1,446	1,475
Cash Cost (A\$/oz)						
Carouse Dam		684	673	655	693	683
Avg Cash Cost (A\$/oz)		684	673	655	693	683
Avg Total Cost (A\$/oz)		746	756	775	841	843
RATIO ANALYSIS (A\$m)		2010f	2011f	2012f	2013f	2014f
CF (A\$m)		14	57	56	59	65
CF / Sh (Ac/sh)		4	11	11	12	13
CF Ratio (x)		12.4	3.8	3.8	3.7	3.3
Earnings (A\$m)		11	43	42	42	46
EPS (Ac/sh)		2.7	8.6	8.4	8.4	9.1
EPS Growth (%)		-196%	216%	-2%	1%	9%
Earnings Ratio (x)		16.2	5.0	5.1	5.1	4.7
E'prise Val. (A\$m)		158	153	131	97	46
EV : EBITDA (x)		8.2	2.2	1.8	1.3	0.6
EV : EBIT (x)		10.2	2.6	2.3	1.7	0.8
Net Debt / ND+Eq (%)		-36%	-84%	-102%	-148%	-255%
Interest Cover (x)		(43)	(39)	(22)	(16)	(13)
EBIT Margin (%)		30%	40%	39%	38%	39%
ROE (%)		15%	33%	26%	22%	20%
ROA (%)		17%	43%	33%	28%	25%
Div. (Ac/sh)		-	-	-	-	-
Div. payout ratio		0%	0%	0%	0%	0%
Div. Yield		0%	0%	0%	0%	0%
Div. Franking		0%	0%	0%	0%	0%

PROFIT AND LOSS (A\$m)	2010f	2011f	2012f	2013f	2014f		
Gold Sales	52	152	146	150	155		
Hedging Revenue	0	0	0	0	0		
Deferred Revenue	0	0	0	0	0		
Interest Revenue	1	2	3	4	5		
Other Revenue	0	0	0	0	0		
TOTAL REVENUE	53	153	149	154	161		
Operating Costs	28	76	70	72	72		
Dep/Amort	3	9	13	15	17		
W/O & Provisions	1	1	1	1	1		
Corp O/H	5	5	5	5	5		
EBITDA	19	71	71	73	78		
EBIT	16	60	57	57	60		
Interest Expense	1	0	0	0	0		
NPBT	16	61	60	60	65		
Tax	5	18	18	18	20		
Minorities	0	0	0	0	0		
NET PROFIT	11	43	42	42	46		
Net Abnormal Gain/(Loss)	0	0	0	0	0		
NET PROFIT After Abn'l	11	43	42	42	46		
CASH FLOW (A\$m)		2010f	2011f	2012f	2013f	2014f	
Net Profit		11	43	42	42	46	
+ Working Capital Adj.		-5	0	0	0	0	
+ Dep/Amort		3	9	13	15	17	
+ Provisions		1	1	1	1	1	
+ Tax Expense		5	18	18	18	20	
- Tax Paid		0	15	18	18	18	
- Deferred Revenue		0	0	0	0	0	
Operating Cashflow		14	57	56	59	65	
-Capex + Development		25	26	22	13	4	
-Exploration		7	12	12	12	10	
-Assets Purchased		8	0	0	0	0	
+Asset Sales		0	0	0	0	0	
+ Other		0	0	0	0	0	
Investing Cashflow		-40	-38	-34	-25	-14	
+Equity Issues		27	12	0	0	0	
+Loan D'down/Receivable		10	0	0	0	0	
-Loan Repayment		10	0	0	0	0	
-Dividends		0	0	0	0	0	
Financing Cashflow		26	12	0	0	0	
Period Sur (Def)		1	31	22	34	51	
Cash Balance		29	60	82	116	167	
BALANCE SHEET (A\$m)		2010f	2011f	2012f	2013f	2014f	
Assets							
Cash		29	60	82	116	167	
Current Receivables		0	0	0	0	0	
Other Current Assets		2	2	2	2	2	
Non-Current Assets		61	78	87	85	72	
Total Assets		92	140	171	203	241	
Liabilities							
Borrowings		9	0	0	0	0	
Current Accounts Payable		2	2	2	2	2	
Other Liabilities		7	7	7	7	7	
Total Liabilities		18	9	9	9	9	
Net Assets		75	131	163	194	232	
RESERVES AND RESOURCES		Reserves			Resources		
		mt	g/t	koz	mt	g/t	koz
Sth Laverton		16.7	1.6	875	54.8	1.7	3,040
Equity Share Gold				875			3,040
Enterprise Value / oz (A\$)				206			59

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