Saracen Mineral Holdings (SAR.AX): Still early days in the growth story; initiate Buy

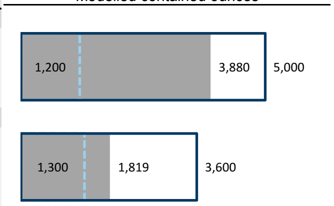
Exhibit 40: SAR operating and financial summary

Commodity and FX assumption	Units	2017A	2018A	2019E	2020E	2021E	2022E	2023E
AUD:USD	**$:$**	**0.75**	**0.78**	**0.73**	**0.73**	**0.74**	**0.74**	**0.74**
Gold	**US$/oz**	**1,258**	**1,298**	**1,255**	**1,363**	**1,474**	**1,487**	**1,488**
Gold	A$/oz	1,668	1,675	1,727	1,865	2,003	2,013	2,015
Operating assumptions	Units	2017A	2018A	2019E	2020E	2021E	2022E	2023E
Mill throughput and grade								
Carosue Dam	kt	2,469	2,479	2,522	2,500	2,550	3,000	3,000
- grade	g/t	2.15	2.32	2.66	2.75	2.80	2.80	2.80
Thunderbox	kt	2,305	2,656	2,766	2,700	2,700	2,700	2,700
- grade	g/t	1.72	1.79	1.70	1.80	2.00	2.20	2.20
Gold production								
Carosue Dam	koz	156	171	202	208	216	254	254
Thunderbox	koz	117	145	142	148	165	181	181
Gold total	**koz**	**273**	**316**	**344**	**356**	**380**	**435**	**435**
Guidance	koz			325-345				
Production Growth	**%**	**44.6%**	**16.0%**	**8.7%**	**3.4%**	**6.9%**	**14.3%**	**0.0%**
Unit costs (AISC)								
Carosue Dam	A$/oz	1,413	1,199	1,079	1,116	1,186	1,092	1,123
Thunderbox	A$/oz	1,262	1,074	1,051	861	1,133	1,068	1,098
Group Total	**A$/oz**	**1,349**	**1,141**	**1,068**	**1,010**	**1,163**	**1,082**	**1,113**
Guidance*	A$/oz			1050-1100				
Financial summary	Units	2017A	2018A	2019E	2020E	2021E	2022E	2023E
Revenue and EBITDA								
Revenue	A$mn	423	511	588	664	762	875	876
Underlying EBITDA	**A$mn**	**108**	**196**	**274**	**356**	**373**	**465**	**455**
Margin	%	26%	38%	47%	54%	49%	53%	52%
Earnings and dividends								
Underlying earnings	**A$mn**	**34**	**67**	**122**	**175**	**174**	**234**	**230**
EPS (pre exceptionals)	Acps	4.1	8.2	14.7	20.6	20.3	26.8	25.9
EPS growth	%	29%	99%	79%	41%	(2%)	32%	(3%)
DPS	Acps	0.0	0.0	2.0	6.0	6.0	8.0	8.0
Payout ratio (% FCF)	%	0%	0%	14%	29%	29%	30%	31%
Dividend yield	%	0%	0%	1%	2%	2%	3%	3%
Cash flow								
Operating cash flow (OCF)	A$mn	126	191	263	346	372	458	453
Capex (incl. exploration)	A$mn	(118)	(130)	(182)	(184)	(106)	(78)	(74)
Acquisitions and divestments	A$mn	0	5	0	0	0	0	0
Net interest and tax	A$mn	(0)	1	(25)	(72)	(70)	(92)	(86)
FCF - before dividends	**A$mn**	**8**	**66**	**56**	**90**	**196**	**289**	**293**
FCF yield	**%**	**0.4%**	**3.1%**	**2.7%**	**4.3%**	**9.3%**	**13.7%**	**13.9%**
Dividends	A$mn	0	0	0	(41)	(49)	(57)	(65)
Buybacks and shares issued	A$mn	0	0	0	0	0	0	0
FCF - before debt	**A$mn**	**8**	**66**	**56**	**49**	**147**	**231**	**227**
Balance sheet and Returns								
Net debt (cash)	**A$m**	**(34)**	**(100)**	**(155)**	**(205)**	**(352)**	**(583)**	**(810)**
Gearing (ND/ND+E)	**%**	**(13%)**	**(35%)**	**(45%)**	**(47%)**	**(86%)**	**(163%)**	**(276%)**
Leverage ratio (ND/EBITDA)	x	(0.3x)	(0.5x)	(0.6x)	(0.6x)	(0.9x)	(1.3x)	(1.8x)
ROA	%	8.8%	14.5%	20.5%	26.3%	20.1%	22.8%	19.2%
ROCE	**%**	**13.6%**	**25.0%**	**39.3%**	**45.4%**	**42.2%**	**62.5%**	**73.5%**
Total Shares O/S	mn	810.5	818.0	818.0	818.0	818.0	818.0	818.0
Divisional EBITDA								
Carosue Dam	A$mn	73	98	159	181	203	266	260
Thunderbox	A$mn	80	100	117	177	172	201	197
Total underlying EBITDA	**A$mn**	**154**	**197**	**276**	**358**	**375**	**467**	**457**
Divisional Capex (inc. exploration)								
Carosue Dam	A$mn	68	64	103	96	47	43	39
Thunderbox	A$mn	96	74	79	88	59	35	36
Total Capex	A$mn	**164**	**138**	**182**	**184**	**106**	**78**	**74**

R&R and Mine Life*		Reserves	Resources	GSe
Carosue Dam				
tonnes	Mt	16.0	80.0	43.0
grade	g/t	2.30	1.90	2.80
contained ounces	koz	1,200	5,000	3,880
mine life	yrs	6	25	15
Thunderbox				
tonnes	Mt	24.0	66.0	24.0
grade	g/t	1.70	1.70	2.36
contained ounces	koz	1,300	3,600	1,819
mine life	yrs	9	25	10

*R&R mine life is implied at 2019e production rates, GSe is 'as modelled'

Modelled contained ounces



Target Price		
NAV	A$/sh	2.84
NTM EV/EBITDA	A$/sh	2.78
Target Price	**A$/sh**	**2.80**
Current Share Price	A$/sh	2.46
Upside / (Downside)	%	14%

GS Recommendation	Buy

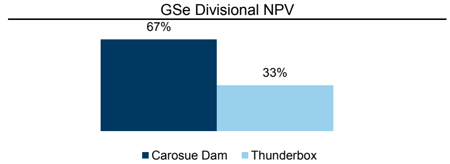
Net Asset Value (FY19)	A$mn	A$/sh
Carosue Dam	1,311	1.60
Thunderbox	655	0.80
Operating assets	**1,966**	**2.40**
Exploration	200	0.24
Net cash/(debt)	155	0.19
NAV	**2,322**	**2.84**

EV/EBITDA Scorecard		
Median sector multiple	**ł sector r**	**GSe****
Financial metrics		
Gearing (high or low)	Positive	(46%)
EPS growth (high or low)	Positive	36%
FCF growth (high or low)	Positive	12%
Capital management outlook	Neutral	1%
ROCE (high or low)	Positive	0%
Operating metrics		
Mine life (>10 yrs)	Neutral	
Cost/margin position (top/bottom half)	Neutral	
Production growth - 2yr outlook*	Neutral	7%
Operating/sovereign risks (high/low)	Neutral	
Adjusted multiple	**7.0x**	

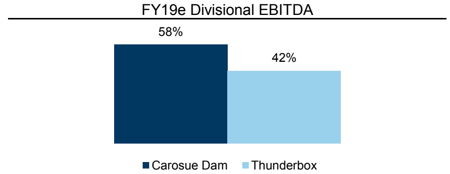
*AuEq at GSe prices **NTM Estimate

GSe EBITDA	2019E	2020E
Next Twelve Months split	64%	36%
EBITDA	274	356
NTM EBITDA	**303**	
NTM EV/EBITDA Valuation	A$mn	A$/sh
NTM EBITDA	303	
EV/EBITDA multiple	7.0x	
Enterprise value	**2,122**	**2.59**
Net (debt)/cash	155	
Equity Value	**2,278**	**2.78**

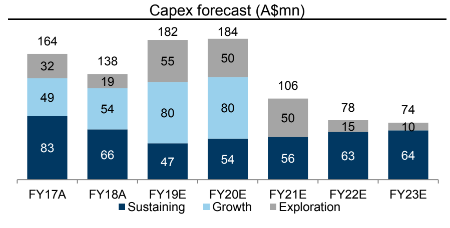
GSe Divisional NPV



FY19e Divisional EBITDA



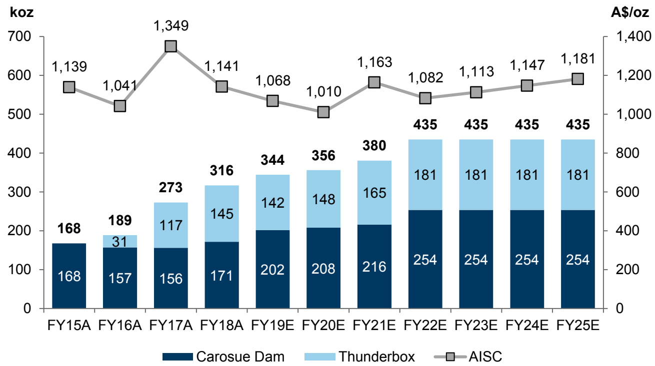
Capex forecast (A$mn)



Source: Company data, Goldman Sachs Global Investment Research

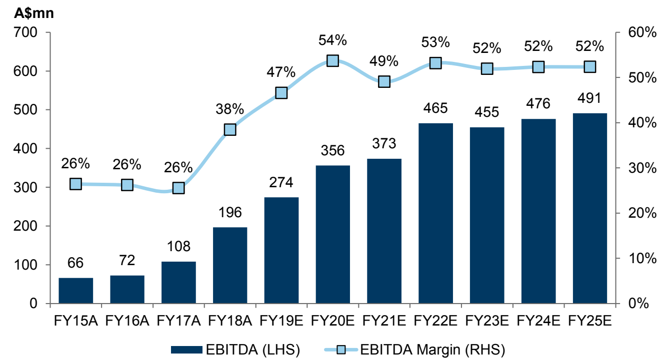
SAR Summary in charts

Exhibit 41: SAR GSe gold production (LHS) and AISC (RHS)



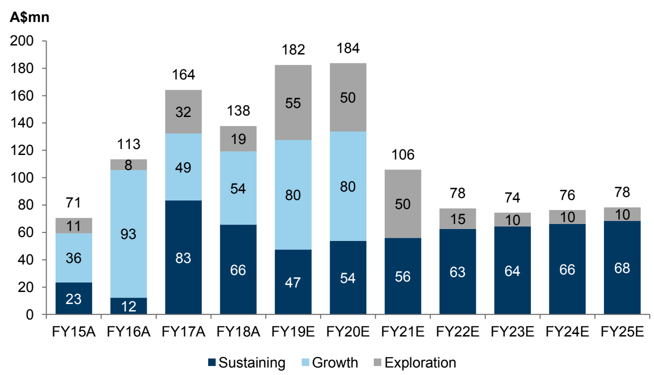
Source: Company data, Goldman Sachs Global Investment Research

Exhibit 42: SAR GSe EBITDA and EBITDA margin



Source: Company data, Goldman Sachs Global Investment Research

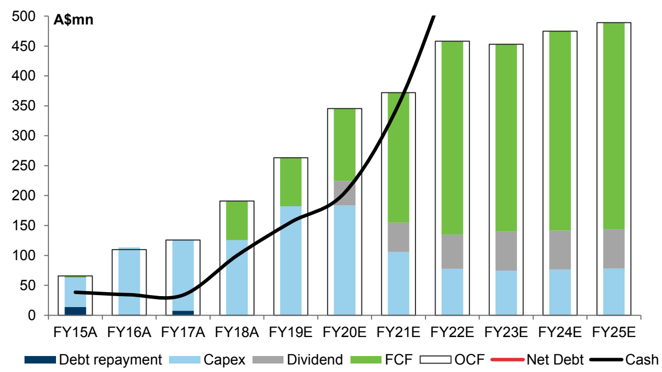
Exhibit 43: SAR GSe Capex profile



Source: Company data, Goldman Sachs Global Investment Research

Exhibit 44: SAR GSe Use of Operating Cash Flow

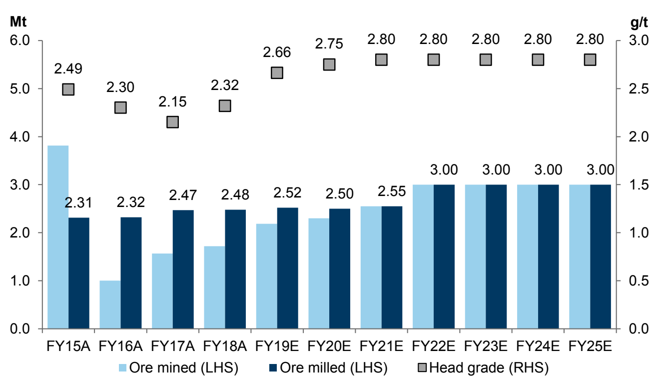
We forecast a modest dividend commencing at the end of FY19



Source: Company data, Goldman Sachs Global Investment Research

Exhibit 45: SAR GSe CDO ore mined & milled and grade

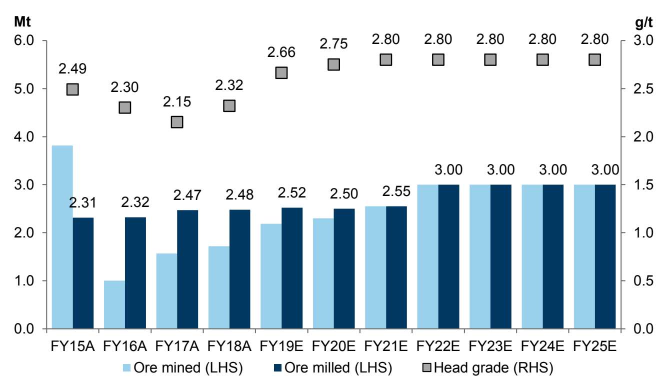
We model expansion to 3.0mtpa and a modest improvement above current reserve grade



Source: Company data, Goldman Sachs Global Investment Research

Exhibit 46: SAR GSe TBO mined & milled ore and grade

Transition to underground feed and drawdown of open pit stockpiles



Source: Company data, Goldman Sachs Global Investment Research

We initiate on SAR with a **Buy** rating and a 12-month target price of **A$2.8/sh**, implying **14% upside** from the current price. SAR operates two Australian gold mining hubs, Carosue Dam and Thunderbox, with combined nameplate milling capacity of c. 5Mtpa. SAR's operations produced 316koz in FY18 at an AISC of A$1,139/oz, well ahead of initial FY18 guidance. FY19 production has been guided to rise to 325-345koz (+3-9% YoY, GSe: 344koz), with AISC falling to A$1,050-1,100/oz (GSe: A$1,068/oz). This can be viewed as just the early stages of an organic growth push towards 400koz p.a. (and potentially beyond) which should result in **lower unit costs, improved margins and cash flow generation, and longer mine lives** at both assets. The key drivers of this growth are simple: reserve growth and life extension through predominantly **brownfields drilling**, **higher grade ore feed** as the mines push underground, and an incremental **capital-light mill expansion** at Carosue Dam. We see production growing to 435koz by FY23 at a sub-A$1,000/oz AISC, with Saracen continuing to generate cash through the immediate investment phase (FY19 FCF yield: 3% post A$135mn growth and exploration capex).

Valuation and investment thesis

Valuation

Our 12-month target price of A$2.8/sh is based on a 50:50 NPV & EV/EBITDA blend:

- **NPV:** Life of mine DCF on CDO and TBO, discounted back to Jun-19 at a 10% nominal WACC. Net asset value includes corporate costs, exploration value and net debt. No NPV multiple is used, and no risk weighting has been applied to either asset.
- **EV/EBITDA**: Based on GS forecast NTM EBITDA multiple of 7.0x, determined through our scorecard vs. ASX mid-tier gold peers and relative to the current sector market cap-weighted trading multiple of 7.0x and considering the production and reserve growth potential relative to peers.

Investment thesis

- **Meaningful value creation through low-cost organic growth:** We forecast SAR growing gold production to 435koz by FY23 (+c.40% on FY18) through a combination of higher-grade ore feed and a low-cost mill expansion at Carosue Dam. We forecast **AISC margins improving** from 32% to 45% by FY23, with **ROIC improving** from 25% to 73% (**second-highest in sector**) over the same period.
- **Coupled with reserve growth/mine life extension:** A$60m exploration program in FY19 should fast-track a doubling of reserves to 4Moz (equivalent to NST's reserve base pre-Pogo acquisition). After a period of constrained expenditure, SAR is now catching up with W.A. gold peers who have already enjoyed a significant re-rate on the back of brownfields exploration success.
- **Catalysts:** Ongoing drill results (c. every few months) from exploration program identifying high-grade underground ore. Lower unit costs expected in December quarterly. CDO mill expansion study expected end of FY19. **We conservatively**

model 3.0mtpa at CDO from FY22, i.e. two full years after the expansion study is delivered.

- **Valuation:** Trading at 0.87xNPV, with 14% upside (15% TSR) to our 50:50 blended target price, with an implied EV/EBITDA multiple of 7.0x (current FactSet consensus: 7.0x). **We are +3%/+18% vs. FactSet consensus for FY19/FY20 EBITDA.**

Key risks

- **Exploration success/failure**, particularly in defining high-grade underground reserves to support the CDO mill expansion.
- **Production interruption** from mining issues or mill failure (in particular Carosue Dam). SAR has a relatively concentrated production base, with older (but recently refurbished) assets.

Financial summary

EBITDA

SAR generated A$196mn of EBITDA in FY18. We forecast this will grow to A$274mn in FY19, driven by the following:

- **increase in produced ounces** from 316koz (FY18) to 344koz (FY19 GSe, vs. 325-345koz SAR guidance), with the YoY growth primarily coming from Carosue Dam (improved grade).
- **decrease in unit costs** from A$1,141/oz (FY18) to A$1,068/oz (FY19 GSe, vs. A$1,050-A$1,100/oz SAR guidance), driven similarly by grade at Carosue Dam but also a decrease in mining costs at Thunderbox as strip ratio falls significantly.
- **higher realised gold price** of A$1,727/oz (FY19 GSe) compared to A$1,606/oz realised in FY18.

With continued low-cost production growth across the group, we expect EBITDA will continue to rise to >A$350mn in FY20 and forecast A$465mn in FY22, the first year we expect group production to exceed 400koz.

Cash flow and capex

This EBITDA growth should be on a backdrop of falling capital expenditure, as the significant investment in exploration and underground development across FY19/FY20 should be sufficient to unlock reserves and support an extension of mine life. Importantly, operating cash flow should also increase significantly over this period as mining costs fall with strip ratio at the Thunderbox C Zone pit.

SAR has guided to A$80mn of growth project spend in FY19 (vs. FY18 A$54.5mn), including:

- Karari paste plant (A$23mn)
- Whirling Dervish underground development (A$20mn)
- Thunderbox underground development (A$13mn)

- Kailis Stage 2 open pit development (A$17mn)
- Carosue dam air-strip (A$7mn)

Additionally, the A$60mn (vs. FY18 $17.3mn) exploration budget will be broadly split evenly between the two operational hubs. We expect total capex of A$182mn.

Beyond FY19, we assume a similar level of capex will be required in FY20 to support growth (CDO & TBO underground development, CDO plant upgrade) and exploration spend to drive resource conversion. We also model continued elevated exploration spend (A$50mn/year) out to FY21, before returning to a more normalised level (A$10mn) beyond this. We think an aggressive 3-year campaign should be more than sufficient in significantly growing the reserve base at both assets, and we model 15 years at Carosue Dam and 10 years at Thunderbox in our DCF valuation.

Production outlook

Carosue Dam

Organic growth at Carosue Dam is a key driver of the company's production growth to 400koz p.a. We see three key elements to production at Carosue growing from 171koz in FY18 to >250koz (GSe) by FY23:

1. **Resource growth and resource-to-reserve conversion**, in particular from extensional and in-fill drilling at the Karari and Dervish undergrounds (A$15mn allocated in FY19 budget). Reserves at the Karari/Dervish undergrounds grew significantly in FY18 on a modest exploration spend of A$13mn (including regional greenfields drilling). With the drilling budget committed in FY19, Saracen has the opportunity to delineate an additional c. 5yrs of reserve life at depth, with recent drill hits supporting the continuation of mineralisation. It should also be noted that the understanding of the Carosue Dam systems is relatively immature compared to regional peers in Kalgoorlie and Laverton given the relatively young operation (just c. 20yrs of mining). Resource conversion will be further supported by the A$23mn investment in the Karari paste fill plant, allowing for >90% resource extraction, including material previously left in pillars, vs. 68% currently. An incremental A$2mn in a second paste pipeline would extend this benefit to Dervish.
2. **Increase in ounces per vertical metre** as grade appears to increase at depth. Both systems demonstrate a trend of increasing grade with depth and therefore increased reserve density, with current mining levels at c.3,000ozs per vertical metre in resource vs. c.~6,000ozs (~3.5g/t) at the limit of current drilling. By comparison, the FY18 head grade was 2.3g/t and the current underground reserve and resource (1.0Moz and 1.9Moz respectively) are both presented at 3.0g/t. Reserves currently extend to a depth of c.500m, just half of the average depth of the WA underground gold peer group.
3. **Plant expansion to at least 3.0Mtpa throughput** through an additional ball mill. We believe this would cost just c. A$25mn, and estimate a c.10% drop in A$/t unit costs through efficiencies and fixed cost dilution. Approval of this investment would be predicated on drilling success through FY19 leading to reserve conversion and an

extended mine life (c. 6-7yrs @ 3Mtpa = c. 20Mt in reserves, vs. current 10Mt reserve/20Mt resource at the Karari/Dervish undergrounds). The company also already owns additional primary crushing capacity on site, which could potentially be installed at a low incremental cost. We can see a scenario where significant exploration success could therefore justify an expansion to 3.2+Mtpa. Refining the grind size with additional grinding capacity could also lead to improved recoveries. These opportunities could present additional upside from our base case of 3.0Mtpa by FY22 with flat recoveries.

While these developments are solely focused around the Karari/Dervish underground system, there is also significant **regional potential along strike** at historical open pits which seem to display similar trends of mineralisation and are historically under-explored at depth. In particular, pits at Montys-Elliot's and Luvironza are just c. 5-10kms from the Carosue Dam mill and could provide additional ore feed or extend life, with A$10mn allocated in the FY19 exploration budget to understanding these systems.

Thunderbox

While we see Carosue Dam as the key lever for the company's growth to 400koz p.a., Thunderbox should also grow production and extend mine life through high-grade underground ore feed and resource conversion from the early-stage Thunderbox underground in particular. TBO will also drive significant cash generation over FY19-21 as strip ratio falls dramatically and stockpiles are consumed. We see three key steps to grow value at Thunderbox:

1. Underground drill drive development (A$13mn) and resource drilling (part of A$30mn TBO exploration budget) to define high-grade core of mineralisation, suitable for extraction via conventional stoping. Similar to the trend observed at CDO, grade has broadly appeared to improve with depth.
2. Beyond the initial drill drive, underground level development targeting the high-grade zones should support a quick ramp-up of underground mining when required. This production level development should be broadly cost-neutral through the extraction of high-grade development ore. We believe Saracen could target a 3.0g/t underground reserve (analogous to Karari/Dervish) with an aim to ramp up an underground operation by FY21, timed for the completion of the C Zone open-pit.
3. After C Zone is complete, underground feed could be supplemented with open-pit ore from Thunderbox D Zone or Bannockburn. Like CDO, this combination of high-grade underground ore supplemented with lower-grade adjacent and regional open-pit feed could support a 10-year mine life on the back of resource conversion achieved in FY19/20.