Talking Point

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West Africa Gold: ASX-listed gold company valuations post the Kinross-Red Back bid.

- **Red Back bid for by Kinross.** Kinross Gold Corp, one of the world's largest gold companies, has bid for the remainder of shares in Red Back Mining that it did not own (the company had a 9% stake initially). The bid values Red Back at a market cap of US$7.1b, or an enterprise value of US$6.3bn. The company has two mines – one in Mauritania and the other in Ghana, which combined produced 350koz of gold in the previous year.

- **Global giant's presence in West Africa now almost complete.** Prior to the bid, Kinross' operations and development projects were in the USA, Ecuador, Chile, Brazil, and Russia. Now it follows Newcrest, Lihir, Newmont, and AngloGold Ashanti into West Africa. Only Barrick, which formerly had a presence in the region, remains the odd man out. However, Barrick is mulling a re-entry.

- **Paying for the regional prospectivity, as well as for cashflows.** Red Back has Canadian JORC-equivalent resources of 12.5moz at an average grade of 2.3 g/t at 1.2g/t cut-off. The Kinross bid values the company at an impressive US$524/oz of resource. Besides paying for the impressive cashflows and production of the mines, we believe Kinross is also paying for the exploration potential that Red Back has in the region.

- **A comparison with Australian companies in West Africa.** As a comparison, we have decided to examine the major West African gold plays in Australia, particularly the companies that were in the region well before it became fashionable late last year. Given that none bar one are yet producing, we have relied on the EV per JORC resource ounces metric as the yardstick. The average multiple that these companies trade at is US$130/oz – which is unsurprisingly significantly below that of the Red Back multiple. There is obvious justification for the marked discount – Red Back has mines that are producing and generating cashflows, whereas the Australian companies (excepting MDL) are not. Red Back also possesses a significantly larger resource inventory.

ASX-listed Gold Companies in West Africa

Company	Code	Country	Price $/share	EV $m	Resources moz	Grade g/t	EV/oz $/oz
Gryphon Minerals	GRY	Burkina Faso	0.83	190	1.1	2.4	**159**
Ampella Mining	AMX	Burkina Faso	1.68	307	1.2	2.0	**236**
Azumah Resources	AZM	Ghana	0.39	74	1.1	2.0	**61**
Mineral Deposits	MDL	Senegal	0.84	516	3.2	2.1	**150**
Castle Minerals	CDT	Ghana	0.35	29	0.2	2.52	**167**
Perseus Mining	PRU	Ghana, Ivory Coast	2.33	811	6.4	1.3	**116**
Adamus Resources	ADU	Ghana	0.55	197	1.9	2.4	**95**
Papillion Rsources	PIR	Mali	0.15	31	0.5	3	**54**
						Average	**130**

Source: *Company reports, Iress, FSB research*

- **The potential for a sizeable re-rating exists if mines are developed.** However, the simple exercise that we have conducted does highlight one salient point - that the potential for a sizeable re-rating of the Australian share prices is available to those companies that can grow their resource base to multi-million ounces, develop their projects, bring mines into production, and generate profitable cashflows.

- **Grade not dissimilar to Red Back's.** One heartening aspect of the comparison is that Red Back's overall head grade between its two mines averages around 2.3 g/t – well in-line with what the Australian gold's in West Africa have so far delineated in their resources.

- **So what should the Australian companies trade at?** Given that most Australian companies are still in the exploration stage, it is difficult to undertake a DCF analysis. We have instead decided to use the multiple Red Back is being bid for and apply it to the resource base of the company. Obviously this is too simplistic – other factors outside of the resource size impact valuations. So we have attempted to account for these by applying discount factors for various parameters as summarised below:

Characteristic	**Comment**
Ore grade:	10% discount for grade <2.3 g/t, 20% for <2.0 g/t, 30% <1.7 g/t, and 40% < 1.5g/t.
Cut-off grade:	10% discount for each 0.1g/t below a 1.0g/t cut-off.
Stage of development:	10% discount for mine construction, 20% for BFS, 30% for PFS, 40% Scoping, 50% for exploration
Asset base:	Discount applied for non-gold asset owned by the company, varying according to its size relative to gold assets.
Refractory issues:	Discount applied, varying according to percentage of ore that is refractory.

- We believe this exercise offers a more realistic appraisal given accounting for the differences between companies. The application of the discount factors are shown below:

Discount Factors (DF) Applied for Various Project Characteristics

Co	Red Back multiple $/oz	DF for stage of project	DF for ore grade	DF for cut/off grade	Df for refractories	DF for non gold asset	DF for met work	Resultant multiple $/oz
GRY	571	50%	0%	10%	0%	0%	0%	257
AMX	571	50%	10%	0%	0%	0%	0%	257
AZM	571	50%	10%	0%	0%	0%	0%	257
MDL	571	0%	10%	0%	0%	50%	0%	257
CDT	571	50%	0%	0%	0%	0%	0%	286
PRU	571	10%	40%	50%	0%	0%	0%	154
ADU	571	10%	0%	20%	25%	0%	0%	308
PIR	571	50%	0%	0%	0%	10%	50%	128

Source: *Company reports, Iress, FSB research*

- Applying the multiple to the companies' various resource sizes, we derive the following valuations. We believe these are more reflective of the various ore characteristics we have examined. Consequently, we have decided to set these as out price targets.

ASX-listed West African Gold Valuation using Multiple Calculated Above

Code	Multiple	EV	Implied Value	Upside/downsdie
	A$/oz	A$m	$m	%
GRY	257	190	1.15	38%
AMX	257	307	1.64	-2%
AZM	257	74	1.29	231%
MDL	257	516	1.32	58%
CDT	286	29	0.47	34%
PRU	154	811	2.44	5%
ADU	308	197	1.52	176%
PIR	128	31	0.31	116%

Source: *FSB research*

Conclusions

Buys:

- **AZM - Azumah Resources (PT $1.29).** While at a similar stage of development as Gryphon and Ampella, and with similar size and grade resource, it puzzles us why the stock is trading at marked discount to those peers. A reason may be that the company is not as widely researched or promoted as the others. Next key catalyst is a resource upgrade from the higher grade Collette prospect. We regard AZM as or No.1 pick in the sector.

- **ADU - Adamus Resources (PT $1.52).** This will be the next company, along with Perseus, to become a producer in West Africa in 2011. Construction is underway. ADU probably unjustly suffers a discount to Perseus from the same issues that Azumah has with its peers - not as well covered or promoted. There is also some concern over the refractory. Concerning the latter, we note that none of the material is booked in Reserves, and that we have discounted in our EV/t valuation. However, a recent announcement on metallurgical testwork on the Salman sulphides, which host the refractory ore, shows positive progress. Therefore, we believe upside exist to reserves.

- **PIR - Papillion Resources (PT $0.31).** Probably the most speculative stock on our list, given its recent entry into West Africa, and the lack of metallurgical testwork results on the ore relative to other companies. Nevertheless, the grade is high, and valuation inexpensive. Plenty of catalysts going forward for a re-rating.

- **MDL - Mineral Deposits (PT $1.32).** The stock has been an underperformer for lack of exploration and the uncertainty over the fate of its mineral sands project. The BFS for the latter was disappointing, especially concerning costs. We believe that value is being discounted mostly for the presence of the sands project, and the only way to unlock it is for MDL to exit the project, via a trade sale or spinout.

- **GRY - Gryphon Minerals (PT $1.15).** A well established player in Burkina Faso, GRY is sitting well with a 1moz resource. We see growth in the resources and remain convinced the stock is a Buy.

- **CDT - Castle Minerals (PT $0.47).** The company has a range of projects located near Adamus' and Azumah's projects. Similar to Papillion in that it is early days, but valuation is inexpensive.

Holds:

- **PRU - Perseus Mining (PT $2.44).** Like Adamus, the company is gearing to come into production via its Ghanian Ayanfuri project next year. We believe the stock is currently fairly valued but definitely a Buy on any weakness. Its Tengrella project in the Ivory Coast we find particularly exciting and will provide significant scope for growth beyond Ayanfuri.

- **AMX - Ampella Mining (PT $1.64).** We like Ampella's Konkera and Batie West projects, which rank just as well as those of Gryphon or Azumah in metallurgy, size, grade, and scope for growth. However, we cannot find any justification why it trades at a significant premium to those two companies. We believe the share price is fairly valued and its peers' valuations represent better entry points into the sector.

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