



November 2020

**Market data**

EPIC/TKR	SGZ
Price (p)	119.75p
12m High (p)	170.00
12m Low (p)	39.60
Shares (m)	56.459
Mkt Cap (£m)	67.61
EV (£m)	71.59
Free Float*	36%
Market	AIM

\*As defined by AIM Rule 26

**Description**

Scotgold listed on the AIM market in 2010 and has focused on developing Scotland's first producing gold mine at Cononish in the Grampian Mountains.

**Company information**

CEO	Richard Gray
Chairman	Nat Le Roux
Fin. Controller	Jeff Hogg

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[www.scotgoldresources.com](http://www.scotgoldresources.com)

**Key shareholders**

Nat Le Roux	41.8%
William Styslinger	11.0%
Peter Hetherington	7.6%
Charles Outhwaite	3.5%
Rhodora Ltd	3.2%

**Diary**

Nov'20	Final results
Mar'21	Interim results

**Analyst**

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# SCOTGOLD RESOURCES

## High grade, low cost and up and running

Scotgold Resources (SGZ) is an AIM-listed gold company, which is commissioning the first phase of the high-grade, low-cost Cononish gold-silver mine in Scotland's Grampian Mountain. In geological terms, the mine is located in the Dalradian Belt, which runs from Scotland to Northern Ireland, and is believed to host more than 5.0m ounces of gold. The company has recently raised £3.0m to begin phase two development at Cononish and fund further exploration work. Our provisional NPV valuation is 167p per share.

- ▶ **Cononish underground mine:** Phase one will see annualised gold production of almost 10,000 ounces. p.a. with the first gold expected by 30 November 2020. Cash operating costs of \$566/oz put Cononish in the lower quartile of the industry's cost curve, helped by the very high-grade ore of 11.6g/t.
- ▶ **Phase two accelerated:** The schedule for Cononish phase two has been brought forward by 11 months to May 2022. This will more than double gold production to at least 23,000 ounces p.a. during the remainder of the nine-year mine life. Gold reserves are currently estimated at 198k ounces with total resources of 266k ounces.
- ▶ **Upside potential:** The Cononish orebody is open at depth below 450m. Furthermore, SGZ has identified several near-mine exploration targets, which have potential to extend mine life. Going forward, the strategy is to develop additional mines in Scotland or other low-risk jurisdictions.
- ▶ **Risks:** SGZ is subject to the normal risks for a junior miner. These include volatility in gold and silver prices, operational risks in executing the mining plan and running downstream processing facilities and funding risks. We believe that jurisdictional risk is significantly reduced in SGZ's case.
- ▶ **Investment summary:** We have estimated a provisional valuation for SGZ is 167p per share. This is based on an NPV valuation using a long-term gold price of \$1,700/oz, a discount rate of 8%, the company's estimated cash operating cost of \$566/oz, a capital cost for phase two of Cononish of \$8.5m and maintenance capex during 2023-29 of \$0.5m p.a.

**Financial summary and valuation**

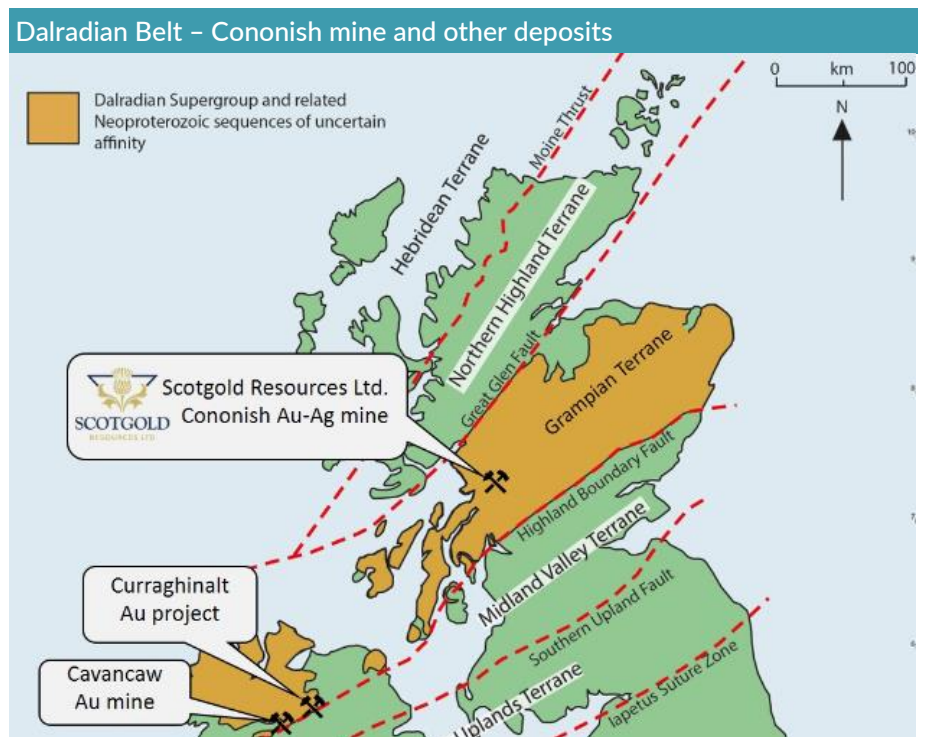
Year-end Dec (\$000)	2015	2016	2017	2018	2019	2020E
Sales	0	0	0	0	0	0
Underlying EBIT	-2,032	-1,506	-1,283	-1,728	-3,423	-2,000
Reported EBIT	-2,032	-1,506	-1,283	-1,728	-3,423	-2,000
Underlying net income	-2,113	-1,506	-1,348	-1,900	-3,518	-2,700
Statutory net income	-2,113	-1,506	-1,348	-1,900	-3,518	-2,700
Underlying EPS (p)	-25.00	-13.00	-8.60	-7.92	-7.84	-5.31
Statutory EPS (p)	-25.00	-13.00	-8.60	-7.92	-7.84	-5.31
Net (debt)/cash	-551	-386	-1,171	9,466	-470	-9,000
Shares issued	8.40	12.74	15.68	23.98	44.89	50.80
P/E (x)	n/a	n/a	n/a	n/a	n/a	n/a
Dividend	0.00	0.00	0.00	0.00	0.00	0.00
Dividend yield	n/a	n/a	n/a	n/a	n/a	n/a

Source: Hardman &amp; Co Research

## Overview and strategy

*SGZ owns the Cononish gold project in Scotland's Grampian Mountains*

Scotgold Resources (SGZ) is an AIM-listed gold exploration company, which was formed in 2007 to acquire 100% ownership of the Cononish gold project in Scotland. SGZ has 13 exploration licences from the Crown Estate Scotland covering 2,900 sq. km. – the Grampian Gold Project – in Scotland's Grampian Mountains. In geological terms, the area is part of the Dalradian Belt – a sequence of heavily folded sedimentary and volcanic rocks – which stretches from northern Scotland to Ireland and is believed to host more than 5.0m ounces of gold resources, e.g. primarily the Curraghinalt (Dalradian Gold) and Cavancaw (Galantas Gold Corp.) deposits.



Source: Scotgold Resources

*Commissioning of phase one is underway*

The company is commissioning the first phase of this high-grade, low-cost underground mine, onstream at the end of last month, making it the first commercial gold producer in Scotland. At full production, the mine will produce an average of at least 23,000 ounces p.a. of gold. It is worth noting that Scottish gold is sought after and often commands a premium to the spot gold price.

*Strategy is to be a multi-asset company*

Going forward, the company's strategy is to use its local expertise, balance sheet and cashflow from the Cononish mine to develop additional mines. These could be similar in scale to Cononish, or potentially larger, in Scotland or other low-risk jurisdictions.

## Cononish mine: first gold imminent

*High-grade gold mineralisation*

The Cononish deposit is characterised by a narrow vein of gold-silver mineralisation with a width of less than six metres. The vein is part of a larger system of quartz veins in the northeast-southwest trending Tyndrum Fault. The gold occurs primarily as electrum (gold-silver alloy) and, to a lesser extent, as native gold. Gold reserves are estimated at 198k ounces at a very high grade of 11.1g/t, as shown in the table below. We would also note that current resource estimate, including Measure, Indicated and Inferred, is 266k ounces of gold at 13.4g/t.

**Cononish mine – proved and probable reserves**

	k tonnes	Gold (g/t)	Silver (g/t)	Gold (k oz)	Silver (k oz)
Proven	65	11.5	51.5	24	108
Probable	490	11.1	47.2	174	743
<b>Total reserves</b>	<b>555</b>	<b>11.1</b>	<b>47.7</b>	<b>198</b>	<b>851</b>

Source: Hardman & Co Research

*Successfully overcome environmental issues*

The company has successfully managed the environmental challenges of developing a mine in the Loch Lomond & The Trossachs National Park. In December 2018, the company announced that it had met all 19 pre-start and other obligations and was able to proceed with construction. The Planning Authority assessed that the impact from environmental and visual perspectives was minor. That said, the project is sensitive to its location, e.g. using gravity separation (25%) and flotation (75%) instead of cyanide in processing. The construction of the mine is also supported by the local community.

*After construction halt due to COVID-19, first gold is expected by the end of November*

The development of the Cononish mine was planned in two phases. Phase one incorporates annual ore and gold production of 36kt and 9,910 ounces, respectively. While the onset of the COVID-19 pandemic led to a temporary cessation of work, construction of the remaining earthworks and process plant resumed in June 2020. With commissioning underway, the first gold from the new mine is expected by 30 November 2020.

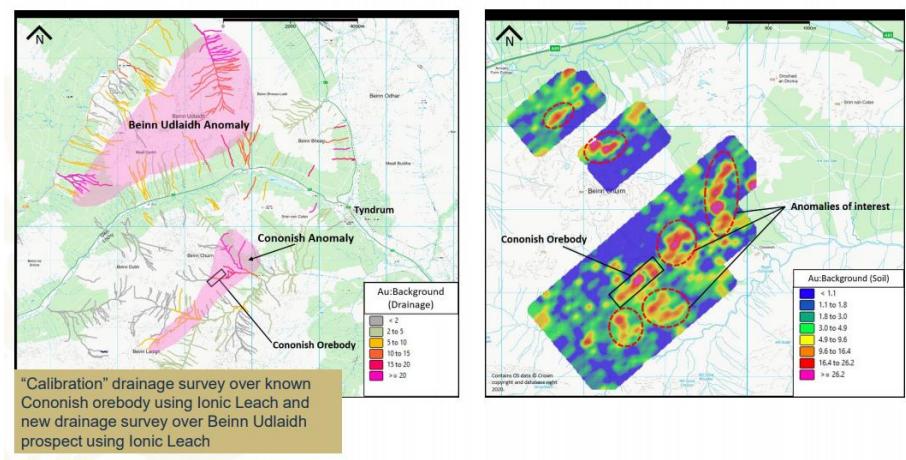
*Phase two is planned for May 2022*

Phase two is currently expected by May 2022, which is 11 months earlier than previously planned. This will see a doubling of ore production from 36kt to 76kt p.a. and take annual gold production from 9,910 ounces to 23,500 ounces p.a. Mine life is currently expected to be nine years with an average operating cost of \$566/oz. If achieved, the mine will be in the lowest quartile of the industry’s cost curve.

*Upside potential from Cononish near-mine development*

The Cononish orebody is open at depth below 450m. Furthermore, SCZ has identified near-mine exploration targets, which have potential to extend mine life. The latest exploration update noted gold and silver anomalies to the north-east of the mine (see below right) that are consistent with the “Mother Vein” structure. The targets also include the Beinn Udlaidh prospect (below left), which was identified by an ionic leach stream sediment survey, and is significantly larger than Cononish.

**Cononish: near-mine exploration and development**



Source: Scotgold Resources

*High gold values detected at Inverchorachan target*

Another potentially significant anomalous target area, Inverchorachan, has been identified, which is also north-east of Cononish. The highest gold values detected from samples at Inverchorachan of 124ppb compare favourably with the highest gold values recorded at Cononish of 39.9ppb, using the same "Ionic Leach" technique.

*Directors and management hold more than 60% of the company*

## Management and valuation

SCZ's M.D. and CEO is Richard Gray who has longstanding experience in operational roles in underground and open-pit mining. This includes four years at Avocet Mining and 10 years at Golden Star Resources. Chairman, Nat Le Roux, was Chief Executive of IG Group Plc 2002-06 and a director of the LME between 2008 and 2016. Jeff Hogg is SCZ's Financial Controller and has more than a decade of experience in mining finance, previously in the diamonds, iron ore and manganese sectors. SCZ's directors and management hold more than 60% of the company's share capital. Nat Le Roux is the largest shareholder with 41.8%, followed by William Styslinger (non-executive) with 11.0% and Peter Hetherington (non-executive) with 7.6%.

*Recent £3.0m funding will support the Cononish expansion and further exploration*

In its latest financial statements for the half-year ending 31 December 2019, SCZ had cash of \$4.57m, borrowings of \$9.06m and net debt of \$4.49m. We estimate that the latter had increased to ca.\$9.0m by the year-end to 30 June 2020. On 12 October 2020, SCZ raised a further \$3.9m (£3.0m) via the placing of 2.727m shares at 110p per share. The funds will be used to finance the expansion of the Cononish mine and to accelerate exploration work across the company's licence areas.

*Our provisional valuation is 167p per share*

Our provisional valuation for SCZ is 167p per share. This is based on an NPV valuation using a long-term gold price of \$1,700/oz (note: we are not assuming any premium to the spot price for Scottish gold at this stage), a discount rate of 8%, the company's estimated cash operating cost of \$566/oz, a capital cost for phase two of Cononish of \$8.5m and maintenance capex during 2023-29 of \$0.5m p.a.

### SCZ - P&L, cashflow and DCF valuation, 2021-30E

\$000 (unless stated)	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	Total
Sales: Gold (k oz)	6,000	13,000	23,000	23,000	23,000	23,000	23,000	23,000	23,000	5,000	185,000
Silver (k oz)	24,000	52,000	92,000	92,000	92,000	92,000	92,000	92,000	92,000	20,000	740,000
Gold price (\$/oz)	1,900	1,700	1,700	1,700	1,700	1,700	1,700	1,700	1,700	1,700	
Silver price (\$/oz)	24.00	22.00	22.00	22.00	22.00	22.00	22.00	22.00	22.00	22.00	
Revenue	11,976	23,244	41,124	41,124	41,124	41,124	41,124	41,124	41,124	8,940	332,028
Operating costs	-3,396	-7,358	13,018	13,018	13,018	13,018	-13,018	-13,018	-13,018	-2,830	-104,710
Op. cost/oz	566	566	566	566	566	566	566	566	566	566	
EBITDA	8,580	15,886	28,106	28,106	28,106	28,106	28,106	28,106	28,106	6,110	227,318
EBITDA margin	71.6%	68.3%	68.3%	68.3%	68.3%	68.3%	68.3%	68.3%	68.3%	68.3%	
Depreciation	-2,300	-4,897	-4,897	-4,897	-4,897	-4,897	-4,897	-4,897	-4,897	-4,897	
EBIT	6,280	10,989	23,209	23,209	23,209	23,209	23,209	23,209	23,209	1,213	
Tax	-1,193	-2,088	-4,410	-4,410	-4,410	-4,410	-4,410	-4,410	-4,410	-230	
<b>NOPAT</b>	<b>5,087</b>	<b>8,901</b>	<b>18,799</b>	<b>18,799</b>	<b>18,799</b>	<b>18,799</b>	<b>18,799</b>	<b>18,799</b>	<b>18,799</b>	<b>982</b>	<b>146,563</b>
Depreciation & amort.	2,300	4,897	4,897	4,897	4,897	4,897	4,897	4,897	4,897	4,897	
Capex & exploration	-2,000	-6,528	-500	-500	-500	-500	-500	-500	-500	0	
<b>Free cashflow</b>	<b>5,387</b>	<b>7,270</b>	<b>23,196</b>	<b>23,196</b>	<b>23,196</b>	<b>23,196</b>	<b>23,196</b>	<b>23,196</b>	<b>23,196</b>	<b>5,880</b>	<b>180,911</b>
<b>Discount rate = 8%</b>											
Discount factor	1.00	0.93	0.86	0.79	0.74	0.68	0.63	0.58	0.54	0.50	
<b>Disc. free cashflow</b>	<b>5,387</b>	<b>6,732</b>	<b>19,887</b>	<b>18,414</b>	<b>17,050</b>	<b>15,787</b>	<b>14,618</b>	<b>13,535</b>	<b>12,532</b>	<b>2,941</b>	<b>126,883</b>
<b>Cum. disc. FCF</b>	<b>126.883</b>										
Net (debt)/cash	-5.130										
<b>Total</b>	<b>121.753</b>										
FD shares (m)	56.459										
Valuation (\$)	2.16										
\$/£	1.29										
<b>Valuation (£)</b>	<b>1.67</b>										

Source: Hardman & Co Research

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