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# THE LONG PULL

## Allied Gold (AAUC): Too Cheap To Ignore

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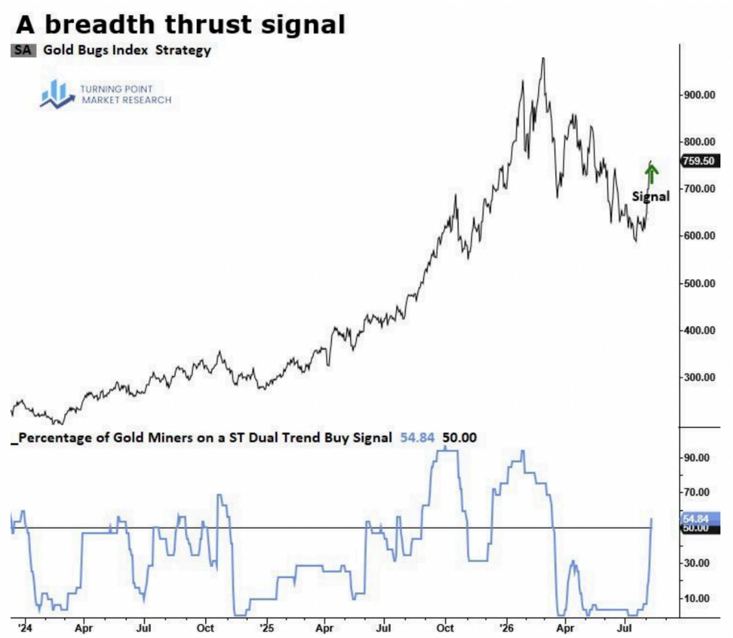
Gold, silver, platinum, palladium, and pretty much every other metal broke out today. As Alex noted this morning in our bond trade alert, "the Treasury is erring on the aggressive side of managing markets."

This means **yields down**, **dollar down**, and **hard assets up.**

We increased our precious metals/commodities exposure in the MO Tracking Port this morning via ETFs, futures, and single-name equity exposure.

Shout-out to Dean for highlighting the breadth thrust signal in gold miners earlier this week (see below).




According to Dean's historical data, the signal has a 100% hit rate (so far):

> *"Over the subsequent five- and six-month periods, the NYSE Gold BUGS Index rallied 100% of the time, although the gain in 2014 was fairly modest. More importantly, both horizons produced statistically significant results."*

So you're telling me there's a chance??

Dean's systems are great for finding the relative strength leaders in a group like gold miners. And now that Dean is on the MO team, it frees me up to focus on things like: **what is the hairiest, cheapest, most contrarian gold play I can find?**

I found it, and it's **Allied Gold (AAUC).**

AAUC is an African-based gold miner with three assets across Mali, Côte d'Ivoire, and Ethiopia. Here's why you should care about this idea despite the hair.

The company **trades at ~2x next year's cash flow at $4,000/oz gold.** They're ramping production with a pathway to **reduce AISCs from ~$2,200/oz to $1,200/oz.** They own three world-class assets that **would be worth 1-1.5x NAV** in any other jurisdiction. Finally, they just started production at the Ethiopian mine, which, at steady state, is **worth nearly the company's entire market cap** (get the two other assets for basically nothing).

The stock retraced as much as 40% from its highs following the termination of the Zijan takeover and is forming a strong bull bar at the midline on the monthly chart.

Remember … there are no such things as great companies, only great bets. And AAUC proves that. It's simply too cheap to ignore.

## The Bad News: Mali Isn't Great

I'll get the bad news out of the way first so we can focus on the good stuff the rest of the time.

The bad news is that Mali isn't *the greatest* jurisdiction for mining if your goal is to keep and sell the gold you mined. Here's a great example of what it's like to do business in Mali.

Last year, the Malian military government seized 3 tons of gold from Barrick and took control of its Loulo-Gounkoto gold complex over some "tax" and "revenue" claims. That dispute lasted two years until Barrick paid $430M to get its stolen gold and the keys to its mine complex back.

I won't lie and say, "*trust me bro Mali is cool now because Barrick walked so Allied could run.*" Mali remains a Tier 2 or 3 jurisdiction, and there will always be the risk of waking up to find the Malian government assuming control of the mine.


But everyone knows Mali is risky. That's why the stock trades at 2x next year's cash flow. My variant perception is that a) the Mali risk is overblown and not as likely to happen as the share price reflects, and b) the stock is still cheap even if you assume $0 in value to the Mali asset.

## The Good News: Production Growth + AISC Reduction

AAUC has three main assets (with most recent Q2 production):

1. Sadiola (Mali): 48Koz
2. Kurmuk (Ethiopia): not online yet
3. Agbaou and Bonikr (Côte d'Ivoire): 49.3Koz

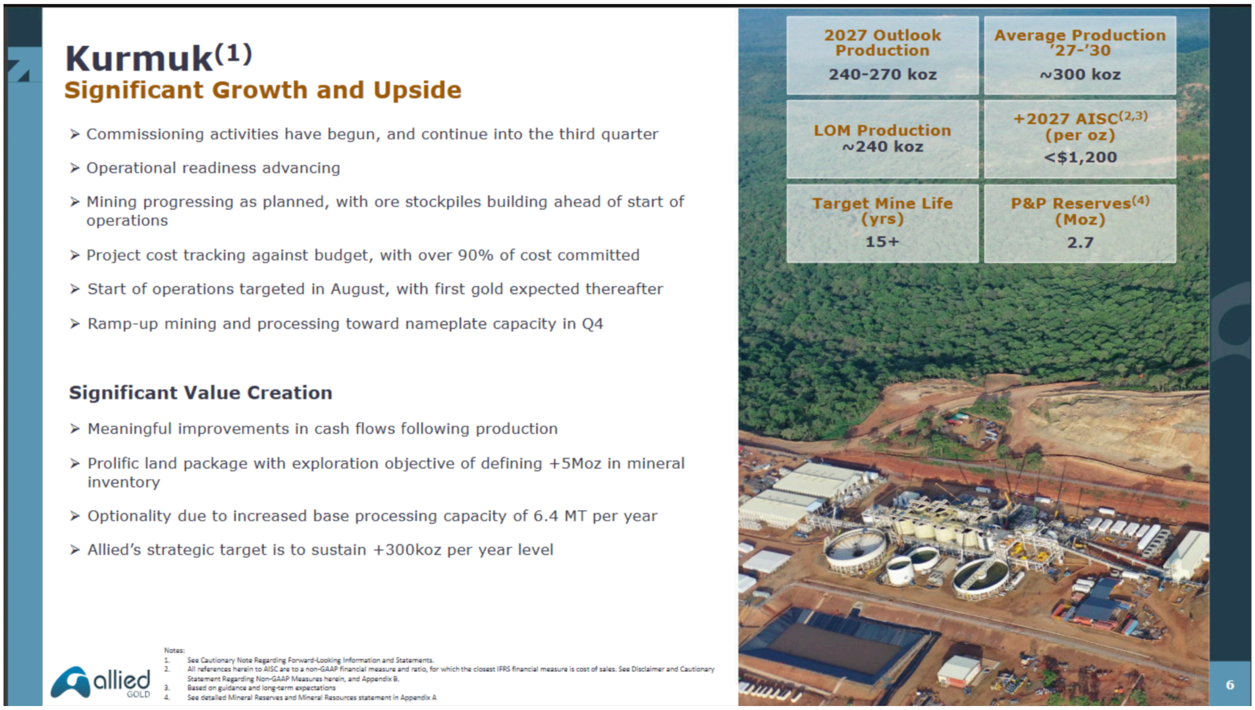
Combined, the company produced 97 Koz of gold in Q2, for an FY run-rate production of 388 Koz at an average AISC of $2,200.

I don't like AAUC for current production. I like it because AAUC has two levers for value creation over the next 12-18 months that aren't reflected in the company's current stock price:

1. **Production growth from Kurmuk**
2. **AISC reductions as Kurmuk generates a greater share of total production volumes**

Let's start with production growth. Kurmuk is the company's Tier-1 Ethiopian asset. Check out the slide on Kurmuk from the company's pitch deck below.




At steady state, Kurmuk will produce ~275Koz/year with AISCs <$1,200/oz. In other words, once online, Kurmuk will add 70% of AAUC's current production rate **from a single mine.**

Not only does Kurmuk increase production by 70%, but it lowers average AISCs by ~19% (see below).

| | Production | AISC |
|---|---|---|
| Kurmuk | 275,000 | $1,200 |
| Ex-Kurmuk | 388,000 | $2,200 |
| | | |
| Total | 663,000 | |
| Weighted AISC | $1,785 | |

The company argues that it will reduce AISCs across its other assets to $1,500/oz over the coming years. But the stock is so cheap, and Kurmuk makes such a difference that we don't need cost efficiencies in any of the other mines to make this work.

Here's the math just for fun (it gets silly).

| | | Reduction from Current |
|---|---|---|
| AISC at $2,200 | $1,785 | -18.85% |
| AISC at $1,500 | $1,376 | -37.47% |

But again, let's stick with the blended $1,785 as our assumed AISC for modeling purposes.

## The Kicker: Buy Kurmuk, Get The Rest For Basically Free

The biggest hangup with this stock is that its most prominent producing asset is in a country that can seize operations (and your gold) whenever it wants, then demand $430M to get it back.

My take is that you don't need the Mali asset to make money here. In fact, you can write down Sadiola at $0 and still come out ahead at the current price … ***if Kurmuk hits its production targets.***

The best way to value AAUC is to value Kurmuk as a standalone asset, then subtract that value from the rest of the company to get a "stub value" on Sadiola and the Côte d'Ivoire mines.

Here's my napkin valuation on Kurmuk (see below).

| | |
|---|---|
| **Kurmuk** | |
| Production | 223,000 |
| Gold Price | $4,000 |
| AISC | $1,200 |
| *Less: Stream + Hedge drag* | $188 |
| Pre-tax cash flow | $582,476,000 |
| 4.5x EBITDA | **$2,621,142,000** |

I used 4.5x EBITDA as that's the going-rate valuation for West African peers like Kurmuk. But anywhere around 3-5x EBITDA is probably fine.

That gives me $2.6B in EV.

The entire company trades for $3.24B as of this report. That means we can assign a "stub value" of **$619M.**

Here's what you get for $619M of stub value.

| | |
|---|---|
| **Sadiola + Agbaou and Bonikr** | |
| Production | 388,000 |
| Gold Price | $4,000 |
| AISC | $2,200 |
| Pre-tax cash flow | **$698,400,000** |
| Stub Value/Pre-tax CF | 0.89 |
| Stub Value CF Yield | 112.85% |

Now ask yourself. Is the jurisdictional risk of Mali and Côte d'Ivoire really worth *that significant* of a valuation haircut? **You're paying <$1,600 per production ounce for these assets**, assuming steady-state/normalized multiples on Kurmuk.

What happens if we get another leg up in this gold bull market? What happens if gold hits $5,000/oz? Do you think these assets should still trade for <1x cash flow? Probably not.

## Concluding Thoughts: Too Cheap To Ignore

I get it. Mali is scary. China not approving the deal is scary. All of that is priced into the stock today. You're buying good assets at fantastic prices because people are scared to invest in certain places.

That's fine.

Remember, there are no great businesses, only great bets.

AAUC is too cheap to ignore. At these prices, you are well compensated for taking jurisdictional risk. In fact, if Kurmuk reaches steady-state production, you don't even need the Mali assets. That cash flow becomes gravy.

Your downside is protected by the company's cash-flow-generating abilities, its trough valuation in a secular gold bull market, and a solid balance sheet post-Zijan's strategic investment.