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28 August 2020

Equity Research

BUY

Target Price: 6.73p (4.67p)

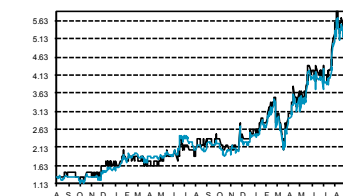
Share Price: 5.10p

Key Data

Market Cap	£54m
DS Mining	14,148
Sector	Mining
Stock Codes	ARNR.L / AAU LN

Last Published Research: 9 July 2020

Absolute & Relative Performance



— Absolute
— Relative to DS Mining

Source Datastream

Investment Research

Ariana Resources

Operational delivery highlights further potential

Ariana, a long-time favourite of ours in the small-cap Gold mining sector, continues to deliver as expected. Despite the considerable re-rating seen in the shares since March, we continue to believe that Ariana offers an exciting opportunity for investors to gain exposure to a profitable, cash generative Gold producer with an attractive exploration pipeline.

- **Q2 Operational update** – Ariana's Q2 Operational update confirmed the previously reported production rate of 4,679oz and the positive impact of higher precious metal prices in the period. Due to Silver credits, Ariana realised average revenues per Gold ounce produced of \$2,116/oz, materially higher than the average Gold price of \$1,717/oz for the period. Kiziltepe retains its highly attractive cost profile with operating costs in the period of \$492/oz, notably below our \$623/oz forecast for FY2020.
- **Model updated** – In addition to revising our commodity price forecasts for gold exploration assets and incorporating the company's Q2 production results, we have undertaken a review of the Ariana portfolio. Using a 10% discount rate, we estimate that Ariana is currently trading on a P/NAV of 0.55x, which compares to >1.0x typical for large-cap peers and to 0.60x in our last quarterly publication. This discount to our normalised intuitive multiple of 1.0x NAV (assuming our NPV estimates incorporate the changes in production, future production efficiencies and any change in costs) looks anomalous given the low-cost nature of the operations at Kiziltepe and the potential for incrementally high-margin production growth. Further supporting our positive view is that, at our 10% cost of capital, the long-term price of Gold to justify the current equity valuation is ~\$1,200/oz.
- **Reiterate Buy recommendation with increased target price of 6.73p (4.67p)** – Our valuation, generated by using a blended average of NAV per share, earnings per share and cash flow per share implies a target price of 6.73p (4.67p). Our approach to evaluating Ariana uses the same methodology as that applied to our senior Gold equity valuations. The rationale for this approach is to reflect what we believe is the final evolution in the Ariana investment case, from an exploration and development company to one that is also profitable and cash generative and is therefore an acknowledgement of this successful evolution.

Year End	Sales	PBTA	EPS	DPS ord	P/E	EV/EBITDA	Yield
Dec	(£m)	(£m)	(p)	(p)	(x)	(x)	(%)
2019A	8.4	7.0	0.7	0.0	7.8	7.3	0.0
2020E	5.7	4.2	0.4	0.0	13.4	11.4	0.0
2021E	5.9	4.3	0.4	0.0	14.2	10.3	0.0
2022E	7.4	5.7	0.4	0.0	11.9	5.9	0.0

Source Company Data, Panmure Gordon

WHAT IS ARIANA WORTH?

In line with our stated commitment to offer a consistent approach to appraising our Gold equity sector coverage, as per our underlying commodity opinions and appropriate risk premiums applied to Gold equity companies, our key objective is to ascertain whether or not a valuation anomaly is presenting itself and whether investors can benefit.

In addition to incorporating our new price forecasts for Gold exploration assets (\$200/oz for Measured, \$50/oz for Indicated and \$25/oz for inferred ounces from \$100, \$25 and \$10 respectively), we have undertaken a review of Ariana's portfolio of assets following the publication of the company's Q2 Operational update. Using a 10% discount rate, we estimate Ariana is currently trading on a P/NAV of 0.55x, which compares to >1.0x typical for large-cap peers. This discount to our normalised intuitive multiple of 1.0x NAV (assuming our NPV estimates incorporate the changes in production, future production efficiencies and any change in costs) looks anomalous given the low-cost nature of the operations at Kiziltepe and the potential for incremental production growth.

Assuming no significant exploration success in the short term and subsequent capital expenditure requirements, we estimate that at our 10% cost of capital, the long-term price of Gold to justify the current equity valuation is ~\$1,200/oz, underpinning our positive view on Ariana.

In light of the diverse range of views on both appropriate risks and longer-term Gold prices, we have provided a share price matrix for investors to apply their own variables and derive an appropriate NAV target price for Ariana (p/share).

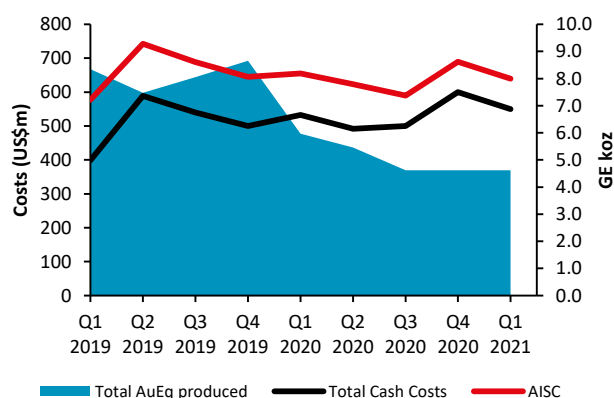
Ariana valuation matrix (p)

Gold price		1300	1400	1500*	1600	1700	2000
Discount rate	13%	7.59	8.14	8.62	9.12	9.58	11.02
	12%	7.79	8.30	8.80	9.31	9.81	11.32
	11%	7.93	8.46	8.99	9.53	10.06	11.65
	10%	8.09	8.64	9.20	9.76	10.32	11.99
	9%	8.25	8.83	9.42	10.01	10.59	12.35
	8%	8.42	9.04	9.65	10.27	10.89	12.74
	7%	8.60	9.25	9.90	10.55	11.21	13.16
	6%	8.80	9.48	10.17	10.86	11.54	13.60

*Panmure Gordon's long term forecast

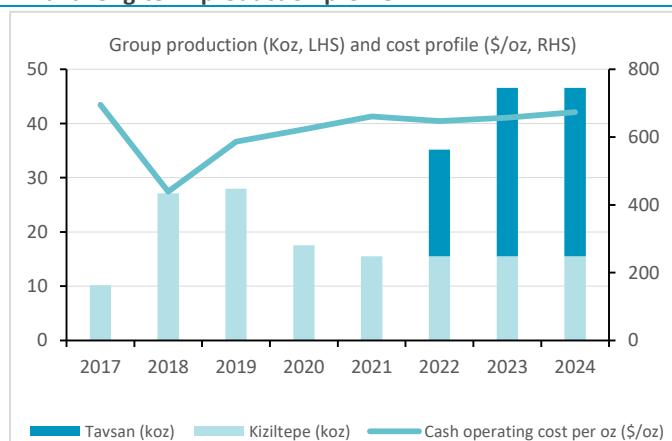
Source Company, Panmure Gordon

Kiziltepe production/cost profile (Koz & \$/oz)



Source Company, Panmure Gordon

Ariana long-term production profile



Source Company, Panmure Gordon

UNDERLYING ASSUMPTIONS

The principal assumptions behind our valuation of Ariana are as follows:

Commodity price forecasts – Annual

	New			Previous		
	Q2	Q3	Q4	Q2	Q3	Q4
Gold (\$/oz)	1,712	1,775	1,750	1,712	1,775	1,750
Silver (\$/oz)	16.3	19.0	19.0	16.3	19.0	19.0
Consensus						
Gold (\$/oz)	1,712	1,706	1,750	1,712	1,706	1,750
Silver (\$/oz)	16.3	17.8	18.0	16.3	17.8	18.0

Source Panmure Gordon

Operational assumptions

	New			Previous		
	2020	2021	2022	2020	2021	2022
Kiziltepe	20.7	18.5	18.5	20.7	18.5	18.5
Tavsan	0.0	0.0	19.7	0.0	0.0	19.7
Salinbas	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0
Total production (Koz Gold Equivalent)	20.7	18.5	38.2	20.7	18.5	38.2
Total cash cost (US\$/oz.)	623	661	647	623	661	647
All-in sustaining costs (US\$/oz.)	672	685	713	672	685	713

Source Panmure Gordon

CHANGES TO OUR ESTIMATES

Summary of changes

	New			Previous		
	2020	2021	2022	2020	2021	2022
Sales (£m)	5.7	5.9	7.4	5.0	5.4	na
PBTA (£m)	4.2	4.3	5.7	3.4	3.7	na
EPS (p)	0.4	0.4	0.4	0.3	0.3	na
DPS Ord (p)	0.0	0.0	0.0	0.0	0.0	na

Source Panmure Gordon

We have provided a summary of changes to our long-term estimates. The main changes made are:

- Incorporation of new resource price assumptions for the Salinbas project
- Review of long-term production profiles at Kiziltepe and Tavsan
- Inclusion of Q2 Operational trading update
- Publication of FY2022 forecasts

VALUATION SUMMARY

Our valuation, now generated by using a blended average of NAV per share, earnings per share and cash flow per share, implies a target price of 6.73p (4.67p). Our approach to evaluating Ariana utilises the same methodology as that applied to our senior Gold equity valuations. The rationale for this methodology is to reflect the final evolution in the Ariana investment case, from an exploration and development company to one that is also profitable and cash generative.

As a reminder, our previous approach to evaluating Ariana, given the relatively early stage nature of production from Ariana, was to apply a simple sum of the parts NPV for each operation.

We continue to apply a discount rate of 10%, this we believe represents a fair assessment of the risk factors influencing Ariana, through the resource exploration phase, project delivery and subsequent production, all whilst satisfying outstanding debt commitments within the joint venture.

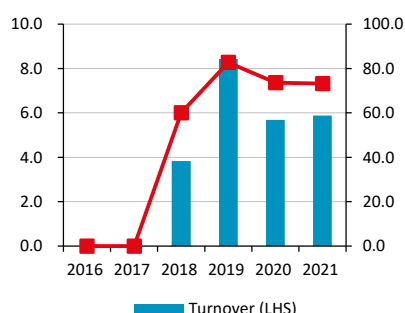
In conclusion, we set a new target price of 6.73p (4.67p) and we continue to see further value opportunities, not fully accounted for at this time, in the company's extensive exploration portfolio, although the route to the monetisation of these assets could be some time away.

Valuation Summary

	\$m Value	Ownership	Attributable value	Value/sh (\$)
Kiziltepe	87,530,175	50%	43,765,087	4.13
Tavşan	32,194,827	50%	16,097,414	1.52
Salınbaş	53,419,928	100%	53,419,928	5.04
Total	173,144,930		113,282,429	10.69
Exploration / Other	608,118	100%	608,118	0.06
Net cash FY+1	7,989,883	100%	7,989,883	0.75
Total	181,742,931			11.50
GBPUSD X Rate	1.25			1.25
Shares in issue (m)	1,059,677,937			1,059,677,937
NAV (£)	145,394,345			9.20
1.0x NAV				9.20
1.5x NAV				13.48
15x FY+1 EPS				5.40
10x CF/share FY+1 (Post Capex)				3.10
Target price (50:50) NAV/EPS				7.30
Target price (50:50) NAV/CF				6.15
Final target price (p)	(50:50 weight)			6.73

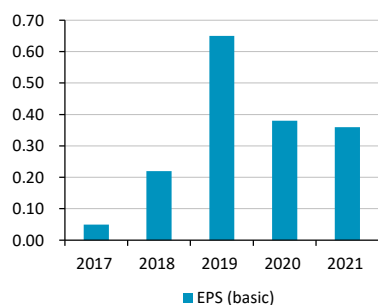
Source Company, Panmure Gordon

Turnover and operating margin (£m)



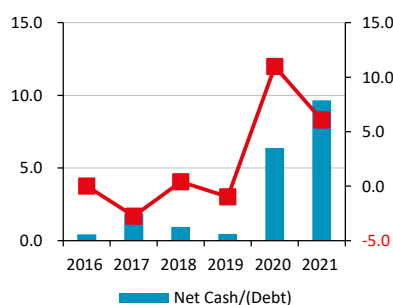
Source Panmure Gordon, Company

EPS normalised (p)



Source Panmure Gordon, Company

FCF yield & net cash balances (£m)



Source Panmure Gordon, Company

Bull Points

- Low cost operational profile
- Long life resource base
- Prospective exploration pipeline

Bear Points

- Risk of production shortfalls
- Weakness in Gold price
- Delays to permitting process

Profit & Loss Account (£m)

Year to December	2018A	2019A	2020E	2021E	2022E
Sales	3.8	8.4	5.7	5.9	7.4
Cost of sales	0.0	0.0	0.0	0.0	0.0
Gross profit	3.8	8.4	5.7	5.9	7.4
Administrative expenses	-1.7	-1.1	-1.5	-1.6	-1.7
Other operating expenses	0.0	0.0	0.0	0.0	0.0
EBITDA	2.1	7.3	4.2	4.3	5.7
Depreciation & amortisation	0.2	-0.4	0.0	0.0	0.0
Operating profit	2.3	7.0	4.2	4.3	5.7
Associates & other income	0.0	0.0	0.0	0.0	0.0
Finance costs	0.0	0.0	0.0	0.0	0.0
PBT normalised	2.3	7.0	4.2	4.3	5.7
Abnormal items	0.0	0.0	0.0	0.0	0.0
PBT reported	2.3	7.0	4.2	4.3	5.7
Taxation	0.0	-0.0	-0.1	-0.5	-1.1
Minorities & preference dividends	0.0	0.0	0.0	0.0	0.0
Profit attributable to shareholders	2.3	6.9	4.0	3.8	4.6

Source Company, Panmure Gordon

Summary Cash Flow Statement (£m)

Year to December	2018A	2019A	2020E	2021E	2022E
Operating profit	2.2	6.4	4.2	5.7	13.4
Operating profit discontinued	0.0	0.0	0.0	0.0	0.0
Depreciation & amortisation	0.0	0.0	0.0	0.0	0.0
Other non-cash movements	-2.1	-5.3	0.0	0.0	0.0
Change in working capital	-1.2	-1.2	1.9	-1.3	-0.2
Other cash movements	0.0	0.0	0.0	0.0	0.0
Operating cash flow	-1.1	-0.0	6.1	4.4	13.2
Taxation paid	0.0	-0.0	-0.1	-1.1	-2.7
Net Investment Income & Other Funding	1.4	0.0	0.0	0.0	0.0
Capital expenditure (net)	-0.1	-0.4	0.0	0.0	0.0
Free cash flow	0.2	-0.5	5.9	3.3	10.6
(Acquisitions)/disposals	0.0	0.0	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	0.0	0.0
Shares issued/(repurchased)	0.0	0.0	0.0	0.0	0.0
Other financing	0.0	-0.0	0.0	0.0	0.0
Movement in net cash/(debt)	0.2	-0.5	5.9	3.3	10.6
Net Cash/(Debt)	0.9	0.5	6.4	9.7	20.2

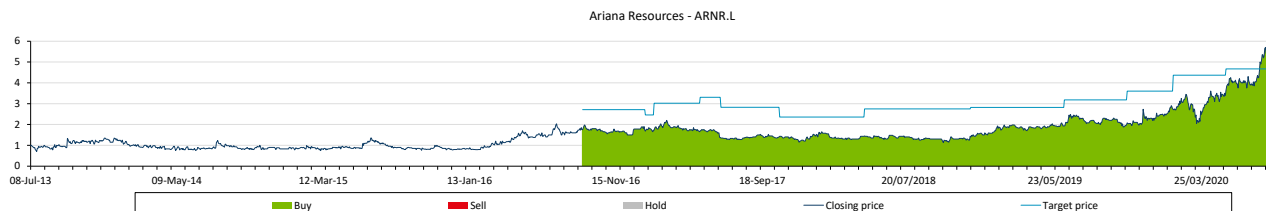
Source Company, Panmure Gordon

Balance Sheet (£m)

Year to December	2018A	2019A	2020E	2021E	2022E
Goodwill and intangibles	17.5	16.6	17.3	17.3	17.3
Tangible fixed assets	0.3	0.1	0.1	0.1	0.1
Working capital	1.7	4.3	2.5	3.8	4.0
Assets employed	19.5	20.9	19.8	21.1	21.3
Other assets/(liabilities)	2.4	6.1	6.4	6.4	6.4
Net cash/(debt)	0.9	0.5	6.4	9.7	20.2
Provisions	-2.3	-2.2	-2.4	-1.4	-0.4
Net Assets (Reported)	20.6	25.3	30.2	35.8	47.5
Shareholders Funds	15.1	18.8	20.0	19.2	26.7
Minority Interests	5.5	6.4	10.7	16.1	19.3

Source Company, Panmure Gordon

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Overall Global Distribution (Banking Client*)			Buy	Total return of >10% in next 12 months
Buy	Hold	Sell	Hold	Total return >-10% and <+10% in next 12 months
65% (31%)	25% (4%)	10% (0%)	Sell	Total return <-10% in next 12 months
* Indicates the percentage of each category in the overall distribution that were banking and/or corporate broking clients				



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