

# Ariana Resources

Update  
16<sup>th</sup> September 2013

## Positive DFS, Key Permit Submitted at Red Rabbit

Ariana Resources, the Turkey based gold and precious metal explorer, announced in June a positive DFS at its flagship Red Rabbit project, which makes it increasingly likely that the company will transform from gold explorer to producer in H2 2014, in our view. An environmental permit application has been submitted, and the company has also identified exploration assets in close proximity to Kiziltepe that could add significant scale to the project. Our current DCF model suggests value for Kiziltepe of 3.03p. Our stance is Buy with a 3p target price.

### Positive DFS at Red Rabbit

Ariana announced the results of a Definitive Feasibility Study (DFS) at the Kiziltepe sector of the Red Rabbit gold project in Turkey. Highlights include a base case NPV for the project of \$34.4m assuming an 8% discount rate and gold and silver prices of \$1,304/oz and \$22.6/oz, respectively. The NPV is also significant on a 10% basis at \$30.4m, and the economics start to become compelling if metal prices are increased.

### Key Permit Application Submitted

Ariana recently submitted the final Environmental Impact Assessment report for the Kiziltepe gold-silver project, through its Red Rabbit JV vehicle, Zenit. Once positive certification has been granted, construction permitting can then be sought, expected in Q4 2013. In tandem with this, Ariana and its JV partners are currently seeking finance for mine construction and are expecting the mine to be commissioned in H2 2014. We feel the permit application marks an import step towards production.

### Potential Far beyond Kiziltepe

In May 2013 Ariana announced that it has identified an Exploration Target of up to 92Koz Au and 1.1Moz Ag at Arzu Central that could add to the 448Koz Au equivalent JORC resource at Red Rabbit. Ariana also believes that further resources could be delineated from high-grade shoots in the Kiziltepe region. These additions could enable the venture to realise significant scale and extend the mine life. This comes on top of news that the Eldorado JV hosts gold resources in excess of 1Moz.

### Conclusion

We feel Ariana has made significant progress towards production at Red Rabbit and that it is definitely feasible that mining will commence in H2 2014. Our valuation is conservative in our opinion as we do not feel we have been overly aggressive in our assumptions, and we have not valued any assets other than Kiziltepe. While we are still cautious of the risks facing Ariana, such as all permits being approved, we believe it offers investors an undervalued opportunity to gain exposure to a company that is near gold production. Buy with a 3p target price.

## Buy

**Target price**

**3p**

### Key data

Share price	0.95p
52 week high/low	1.80p/0.70p
Primary exchange	AIM
EPIC	AAU
Shares in issue	555.0m
Market Cap	£5.3m
Sector	Mining

### Valuation

Kiziltepe NPV*	£16.8m
NAV	£6.4m
TNAV	£1.1m

\* This is the value of Ariana's 50% stake

### Share price chart



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Table: Financial overview

Year to 31st December	2009A	2010A	2011A	2012A
Revenue (£000)	0	0	0	0
EBITDA* (£000)	(406)	(516)	(1,044)	(799)
PBT (£000)	(402)	(506)	(1,347)	(1,182)
EPS (p)	(0.27)	(0.25)	(0.54)	(0.40)

Source: GECR and company.

Notes: \* Adjusted for non-cash movements

## Positive DFS at Red Rabbit

Ariana has announced the results of the DFS at the Kiziltepe sector of its Red Rabbit gold project in Turkey. Highlights included a base case Net Present Value (NPV) for the project of \$34.4m assuming an 8% discount rate and gold and silver prices of \$1,304/oz and \$22.6/oz, respectively. The NPV is also significant on a 10% basis at \$30.4m, and the economics start to become compelling if the gold price is increased above the assumed levels.

*Table: How Project Economics Vary With the Gold Price*

Scenario	Gold Price (\$/oz)	NPV10	NPV8	IRR	Payback (year)	Cash Cost (\$/eq. oz)
-30%	913	3.5	5.7	13.7	3.6	588
-20%	1,043	12.5	15.3	22.3	3.1	592
-10%	1,174	21.5	24.8	30.3	2.7	596
<b>Base Case</b>	<b>1,304</b>	<b>30.4</b>	<b>34.4</b>	<b>37.8</b>	<b>2.4</b>	<b>600</b>
+10%	1,434	39.4	44	45	2.2	603
+20%	1,565	48.4	53.5	52	2	607
+30%	1,695	57.4	63.1	58.8	1.8	611

Source: Company and GECR

While many details of the model were in line with those reported in the Interim Feasibility Study, it is encouraging to see that cash costs per ounce were revised down from \$678-\$693 to \$588-\$611 following reduced input costs and lower commercial quotations. In addition, capital costs to set up the mine now stand at \$31.1m with a payback period of just 2.4 years, based on a mine-life assumption of eight years. Accordingly, Ariana and its Joint Venture partners on the project are currently seeking finance with targeted first production in H2 2014. We also note that the figures provided here are quoted pre-tax and on a 100% ownership basis.

## Kiziltepe EIA Submitted

On 30<sup>th</sup> August Ariana announced that it has submitted the final Environmental Impact Assessment report for the Kiziltepe gold-silver project, through its JV company in Turkey, Zenit. We feel this demonstrates the commitment of Ariana to the Red Rabbit project and also marks an import step towards production, expected next year.

Once positive environmental certification has been received, final construction permitting can then be sought which is expected in Q4 2013. In tandem with this, Ariana and its JV partners are currently seeking finance for mine construction and it is expected the full mine will be commissioned in H2 2014.

## Red Rabbit Could Extend Far Beyond Kiziltepe

The Kiziltepe project at Red Rabbit is progressing well with mining on track to commence in H2 2014. However this individual asset is only expected to have a mine-life of eight years, whereas Ariana believes there could be sufficient potential resources in and around Kiziltepe to keep the mine operational for in excess of ten years.

On 29<sup>th</sup> May Ariana announced that it has identified an Exploration Target of up to 92,000oz Au and 1.1Moz Ag at Arzu Central that could add to the existing 448,000oz Au equivalent JORC resource at Red Rabbit, if the target is proven up. This target could potentially be mined through underground methods, and could add further scale to the Kiziltepe project, extending the mine life to ten years or more. There are drill programmes proposed at this site that could further cement it as a potential resource. In addition, Ariana believes there are further resource ounces that could be delineated from known high-grade shoots in the Kiziltepe region.

This news comes on top of the announcement in April that the company's Eldorado Joint Venture hosts gold resources in excess of 1 million ounces. We feel it augurs well for

shareholders that Ariana's management is not only focused on progressing workable mining operations, such as Kiziltepe, but that it also has a core focus on continued resource upgrades so that any opportunities that provide new revenue streams or that can add economies of scale, or both, are exploited.

## Directorate Change

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In July 2013 Michael Spriggs stepped down from his role as Executive Chairman in order to reduce his business commitments in preparation for his retirement. Previous Non-Executive Director, Michael de Villiers, has now assumed the role of Executive Chairman. Michael de Villiers has been a director of Ariana since its admission to AIM in 2005.

## Valuation and Forecasts

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Our valuation is based on a DCF of the Kiziltepe section of the Red Rabbit project. We have assumed that 1.17 million tonnes of ore are mined over eight years commencing in H2 2014, with an average gold grade of 3.08g/tonne – we expect the mine to deliver c.100,000oz Au and c.1Moz Ag for sale throughout its lifetime. We expect CapEx of \$25m to be required in 2014, alongside working capital of \$2m before cash flows from metal sales can sustain the operation. The latter is then returned in 2022 when mining is complete. We have assumed a gold price of \$1,500/oz this year that then increases at 1.5% annually, and a silver price of \$25/oz that grows at the same rate. On the other side, we expect cash costs of \$594/oz in 2014 that rise to \$623/oz by 2022. We have assumed a basic tax rate of 20%.

We have discounted all of the after-tax cash flows using a 10% discount rate. This leads us to a total NPV for the project of \$50.4m. However, at the time these cash flows would be realised, Ariana's stake in the JV would be 50%, meaning that \$25.2m or £16.8m of the total value is attributable to it. Net cash was minimal at 31<sup>st</sup> December 2012, meaning that after dividing for the shares in issue, we get value of 3p per share.

We note a few points for investors following the assumptions of our valuation. Firstly, this model values the Kiziltepe section of the Red Rabbit project and does not therefore account for any central costs incurred by Ariana outside of the project (i.e. corporate costs of listing, central staff, etc). Our reasoning for this is that we are not including any of Ariana's additional assets within our valuation, and we also do not include any expansion at Red Rabbit beyond the initial eight year target, which could be significant given the potential scale of identified exploration targets.

We have previously valued Ariana's Eldorado Gold JV at £7.2m based on a peer resource-based valuation. This would more than offset our present value estimate of central costs over the next eight years of £4.3m. We therefore feel our target price of 3p remains underpinned by our DCF model. Furthermore, even if we subtract these costs from our NPV, this still implies a present value of £12.5m, or 2.25p a share. We also have not included any of the c.£1.8m (gross) raised since 31<sup>st</sup> December 2012 in our valuation.

## Conclusion

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Ariana has made some significant progress towards production at Red Rabbit, with the DFS secured and the key environmental permit submitted for approval. We therefore feel it is definitely feasible that mining will commence in H2 2014. We look forward to any future progress updates, particularly concerning financing developments and permit approvals.

Our valuation is conservative in our opinion as we do not feel we have been overly aggressive in our DCF assumptions, and we have not included any of Ariana's assets other than those at Kiziltepe within it. While we are cautious of the risks facing Ariana, such as all permits being approved, we feel the progress-to-date goes some way to

mitigate these. We therefore believe Ariana offers investors an undervalued opportunity to gain exposure to a company that is near gold production, while also having significant additional exploration targets in its portfolio. We also see it as a positive sign that both Michael de Villiers (Executive Chairman) and Dr. Kerim Sener (Managing Director) have increased their stakes in Ariana to 1.39% and 1.21%, respectively in recent weeks. Our stance is Buy with a 3p target price.

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