WEST WITS MINING ANALYSIS

I like gold, you all know that. I believe that we will see gold continue to strengthen over the coming years amidst a backdrop of it returning as the neutral reserve asset of choice, with plenty of buying across the board as a result of that from all sorts of angles. The associated producers, several of which are still undervalued at current gold prices, offer some good leverage to this and one of those names is one that several of you will be familiar with. While it's not part of the Codex portfolio for regular coverage, West Wits Mining is still part of my personal portfolio and I did conduct an extensive analysis piece on it in the past, so now it's time to follow up on that. Now of course it has already ran up a lot since the first purchase after I flagged it in the AUD $0.15-0.20 range last year, even after this ~45% correction from the peak, but now that it has suffered through said correction I wanted to take another closer look at it to see what the company has been up to and whether it's worth re-visiting the company for those who may have missed that first run.

So, what has the company been up to? Well, it has done something this year that almost nobody else in South African gold has managed in over a decade. It poured first gold and turned from a developer into a producer, albeit a very early stage one. For those of you who missed the first analysis piece on the company, time for a refresher. The asset is Qala Shallows, the opening phase of what the company calls its Witwatersrand Basin Project, and it sits roughly 15 kilometers west of central Johannesburg in the old Central Rand goldfield, which is to say right on top of the geology that, and I hope you are ready for some trivial pub quiz knowledge that I always like to throw in, has historically produced something close to a fifth of all the gold ever pulled out of the earth. That is not me getting carried away with the marketing, the Wits Basin really is that absurdly prolific, and the whole bones of the West Wits pitch is that there is still an enormous amount of gold sitting in shallow, well-mapped reefs that the majors walked away from years ago because at a few hundred dollars an ounce it simply was not worth the bother of going back down for it. At four and a half thousand dollars (written out for dramatic effect, because I still can't believe how quickly we got to this number) an ounce, which is roughly where gold trades as I write this after touching the mid $5,000 earlier in the year, the bother starts to look rather more appealing. No I am not going to model for $5500 gold, even as bullish as I am on gold and how tempting it would be to juice the economics, but as you will see in the model later, $4500 will do plenty of good for this company if the gold price just stays where it is.

First gold was poured earlier this year, with the ore trucked to Sibanye-Stillwater's nearby Ezulwini plant and processed under a toll-treatment arrangement, which is a smart way to start because it means West Wits did not have to sink $10s of millions into building and commissioning its own processing circuit before it had earned a single dollar. The mine was officially opened a little before that, billed as the first new underground gold mine in South Africa in what? 15 years? They have recently also broken their 1 West decline through into the historical 2 Level mining horizon, handing them access to a pool of already-developed workings and in-situ ore that should help speed the ramp along. That breakthrough is a bigger deal than it sounds, because mining time and development meters are the two things that kill junior producers, and inheriting old workings shaves both, at least in theory. Now the obvious question, are they actually at full tilt yet, and the honest answer is no, not even close. The ramp is targeting around 5,700 ounces a month, which gets you to roughly 68,000 ounces a year, and the steady-state target of about 70,000 ounces a year is not expected to land until 2028. So there is execution risk here that I do not want to wave away, even if I am bullish on their development. Again, they are a producer, but they are an early-stage producer climbing the development curve, and the next 18-odd months are all about hitting that monthly run-rate without nasty surprises.

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What makes the risk a good deal more palatable, at least to me, is that the funding question has already been answered, and that is usually the big question mark that hangs over that tricky developer to producer re-rating. West Wits secured a ~$50 million facility from ABSA Bank and South Africa's Industrial Development Corporation, somewhere around 875 million rand, then topped that up with a $12.5 million facility from Nebari and an institutional placement of around AUS$34 million that was anchored by a AUS$10 million cornerstone cheque from Tribeca Investment Partners, who are a serious resources outfit and not the sort to write a cornerstone cheque on a whim. Management's line is that the project is fully funded through to steady-state production, and they finished the most recent quarter with around AUS$22 million in the bank. Worth flagging because I found something on it, that earlier filings carried a going-concern note, the proverbial red flag that haunts every pre-revenue developer, and the funding package is what hopefully put that to bed.

The DFS underpinning Qala Shallows was run on a gold price of $2,850 an ounce, which is to say roughly $1,650 below where the metal actually trades today, and even on that deliberately cautious number the economics are eye-watering, which is nice to see as it builds in some downside protection instead of the whole thing crashing down the moment gold dips below $4000. The study outlines nearly 944,000 ounces of gold over a mine life of close to seventeen years, with that steady-state 70,000 ounces a year carrying on for twelve of them, at an all-in sustaining cost somewhere in the region of $1,180 to $1,290 an ounce depending on whether you are looking at the steady-state figure or the life-of-mine average. At $2,850 gold that throws off about $2.7 billion of revenue, a little under $1 billion of free cash flow, a pre-tax net present value at a 7.5% discount rate (you could go with 10% or 12% to be fair given it's South Africa, but let's run with this) of around $719 million and a post-tax NPV of around $500 million. The internal rate of return comes in at 93% pre-tax and 81% after tax, with peak funding of just $44 million and a payback period of roughly 8 months from the end of that peak funding. I have read a lot of feasibility studies and a sub-12-month payback is the sort of number that normally comes with an asterisk the size of a mine shaft. There is one caveat I want to take notice of, which is that the production target leans on inferred resources to fill out the back end, so it carries the standard qualifier rather than resting purely on proven and probable reserves, where the formal ore reserve is closer to 384,000 ounces. The directors argue, reasonably enough given the geology, that inferred ounces in a basin this well understood are about as reliable as inferred ounces get, and I am inclined to give them the benefit of the doubt, but you should know the assumption is in there, because giving people the benefit of the doubt in mining is always a risky endeavor. Liars standing next to holes in the ground etc. etc.

So what is the thing worth? Allow me to do the arithmetic, as it's what I love to do, and let me be clear up front that the company has not published a $4,500 sensitivity, so what follows is my own scaling of their study rather than a number they have stamped their name on. The post-tax NPV of around $500 million was struck at $2,850 gold. Lifting the price to $4,500 is a 58% jump, and because the cost base barely moves (at least on paper that is), almost all of that extra revenue falls straight through to margin, so the operating margin per ounce roughly doubles. After I allow for South Africa's mineral royalty, which climbs toward its 5% cap when a project is this profitable, and for corporate tax, which the gap between the pre-tax and post-tax NPVs implies is dragging off something like 30%, I land on a post-tax NPV at $4,500 gold in the region of $1.0 to $1.2 billion on a hundred-percent project basis. For a sanity check, a broadly comparable North American study released recently showed a 28% rise in the gold price lifting after-tax NPV by 62%, so a leverage ratio of a touch above two, which is right in line with the doubling I am applying here.

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Quick note, it's not a 100% ownership, West Wits owns 74% of the Witwatersrand Basin Project, having lifted its stake from two-thirds over the past year, so the attributable slice of that is somewhere around $750 to $900 million. Set that against a market cap of about AUS$240 million, which converts to right around $160 million, and you are looking at the asset being worth something like 5x the entire company at a gold price that already exists. Put the other way around, the market is paying roughly 0.2 times NAV for a funded, in-production mine (early stage) and the truly strange part is that even on the company's own cautious $2,850 study, the attributable post-tax NPV of around $370 million is more than double the market cap, so you are not even being asked to believe in higher gold prices to find value here, you are simply being asked to believe the study, which has already started turning into actual poured ounces, South Africa or not. The best part though? Qala Shallows is the appetizer rather than the main course, even though it's a pretty massive appetizer, and the bull case for the company looks very promising.

A scoping study a few years back carved the broader WBP into 5 potential development stages, of which Qala Shallows is merely the first, and the global resource now sits at a hefty 7.24 million ounces grading 4.0 grams a tonne, with the core Witwatersrand Basin piece coming in around 5 million ounces at a chunkier 4.66 grams. The reefs are stacked and developed in sequence, starting with the Kimberley Reef that Qala Shallows is mining now, then the Main Reef, then the Bird Reef, and the company has been openly talking about a Phase 2 expansion that lifts annual production from, strap in folks, 70,000 ounces toward roughly 200,000 ounces a year. The financing logic of that expansion is the bit I find most compelling, because the stated plan is to fund it out of Phase 1 cash flow rather than by going back to the market with the begging bowl, and if they can pull that off then the dilution that usually eats junior shareholders alive (get it? Because Qala Shallows is the appetizer? This may be worse than the King Arthur Merlin puns...) simply does not happen.

Image 2 showcases these ongoing site infrastructure developments.

IMAGE 2: OPERATIONAL INFRASTRUCTURE UPGRADES AND UNDERGROUND FLEET EXPANSION ACTIVITIES AT QALA SHALLOWS

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Let me put some rough framing around the optionality to have some fun with te model, with the heavy hedge that there is no published Phase 2 feasibility study yet, only a scoping-level concept, so treat these as my own back-of-the-envelope shapes rather than anything you should bank on. Remember, the assets should already be worth around 5x the current market cap at prevailing gold prices, phase 2 (in whatever shape it may come in) is the proverbial gravy (alright I should stop with the food references now). A tripling of the production rate to 200,000 ounces a year, drawing on a resource base more than 5x the size of what Phase 1 actually consumes, is a step-change that adds operating leverage and mine life on top. Even if I refuse to model Phase 2 properly and simply ascribe a modest in-situ value to the attributable ounces beyond Phase 1, call it the roughly 3.7 million attributable ounces sitting in the broader basin, you can pencil in hundreds of millions of dollars of additional value sitting on top of the producing asset, and that is before the gold price does anything clever. The bull case, stated plainly, is that you are buying a mine that is just starting to get into production and which is worth several times the market cap and getting the next 4 development stages thrown in for free.

There is a kicker hiding in the Bird Reef as well and while I am in this for the gold mining play, the uranium analyst in me can't not at least mention it. That package within the mining right carries uranium potential alongside the gold, and the company has flagged a uranium target there with the idea of a standalone uranium-and-gold operation somewhere down the line. I am not going to pretend that is anything other than blue-sky at this stage, and I would not pay a cent for it today, but in a world where the uranium contracting cycle is what it is, having a uranium option buried inside your gold mine for free could be something that occasionally turns into a very pleasant surprise three or four years later. For now, it's all valued at $0 in the models, as it should.

Plenty can still go wrong here, and the reason the stock trades this cheap has little to do with the market being stupid (although plenty of gold producers are still undervalued right now) and everything to do with a basket of South African risks that are entirely real. Power reliability has been a chronic problem across the country for years, labor relations in South African mining have a long and occasionally violent history, the rand can move against you in a hurry, and physical security at site is a genuine line item that you won't have as soon in Nevada. On top of the country risk you have the company-specific stuff, namely that they are leaning on Sibanye to process their ore rather than controlling their own plant, that the ramp to 70,000 ounces still has to be executed cleanly, and that there has been meaningful share issuance and a consolidation along the way, so the per-share story can be a bit of a messy read. None of that is fatal, at least from what I can tell, but all of it is why you are being offered the asset at a fifth of net asset value rather than at par. Part of it is the market not taking notice, part of it is the risk involved with buying a new South-African producer. Know the risks.

Weigh it all up and if you were to ask me whether I would start a position in the company today, I would answer with yes, yes I would. The bears are right that South Africa is hard and that a junior ramping a new mine can stumble in a dozen ways, but being right about the risks and being right about the price are two different things, and at roughly 0.2 times the net asset value of a funded mine that is already pouring first gold into a $4,500 market, with four more development stages sitting in the pipeline, the risks look pretty priced in. I will keep watching the monthly production numbers, because the whole thesis lives or dies on that ramp, but the way I see it the market has done the one thing it occasionally does with unloved jurisdictions, which is forget to price the ounce entirely. Again though, make sure to do your own due diligence and weigh the risks, in the meantime though I hope you all have a good and healthy rest of your day, cheers! ~Mart

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