HARDMAN & CO.

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ANGLO ASIAN MINING

Prodigious cash generation and FCF yield

Anglo Asian Mining (AAZ) is a highly cash-generative miner of gold, silver and copper from three mines in Azerbaijan, where it has a track record of close cooperation with the government. The company listed on AIM in 2005 and produced its first gold in 2009. In 2018, it produced 83,376 of Gold Equivalent Ounces (GEOs), paid its first dividend and the balance sheet moved into a net cash position. At this stage, we have made the highly conservative assumption of no production beyond 2025. Nevertheless, our DCF valuation of 146p reflects AAZ's prodigious cash generation. Indeed, we estimate that the annual free cash yield during 2019-25 will average 18.7%.

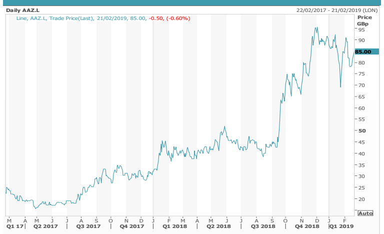
- **Strategy:** AAZ's strategy is to unlock value by creating the leading gold and copper producer in Azerbaijan and leveraging its first-mover advantage and the experience of its management team. This involves maximising production at the lowest possible cost at its main Gedabek site and developing additional production from exploration at other sites in the region, initially Ordubad.
- **First-quartile cost position:** AAZ's last reported figure (1H'18) for AISC was $543/oz, putting it in the first quartile of the gold mining industry's cost curve – due to its Azerbaijani jurisdiction, predominance of open-pit mining, access to the national power grid and investment in efficient downstream processing facilities.
- **Production upside**: Our production estimates for 2019-25 are conservatively based on the proved & probable reserves for the Gedabek open pit and the nearby Ugur deposit. This excludes 833,000 GEOs at the former, which are currently classified as resources, the impending JORC resource at the Gadir underground mine and the exploration potential of the copper-gold porphyry system at Ordubad.
- **Risks:** AAZ faces the normal risks for a junior miner, albeit without the funding risk faced by explorers and developers. These risks include volatility in gold, silver and copper prices, political risks (albeit mitigated in this case), environmental risks, and operational risks in successfully executing the mining plan and operating downstream processing facilities.
- **Investment summary:** The outstanding aspect of AAZ's financial performance is its cash generation, which is reflected in our DCF valuation of 146p per share, using a discount rate of 8% and long-term gold price of $1,300/oz. We expect the company to pay a $0.06 dividend in 2019, implying a dividend yield of 5.6%.

Financial summary and valuation

Year-end Dec ($m)	2015	2016	2017	2018E	2019E	2020E
Sales	78,057	79.184	71.806	90.786	92.894	88.969
Underlying EBIT	-3,189	11.714	9.222	21.528	19.405	16.079
Reported EBIT	-3,189	11.714	9.222	21.528	19.405	16.079
Underlying PTP	-8,910	6.779	5.684	19.870	19.317	16.256
Statutory PTP	-8,910	6.779	5.684	19.870	19.317	16.256
Underlying EPS (c)	-6.58	3.55	2.22	11.13	11.42	9.65
Statutory EPS (c)	-6.58	3.55	2.22	11.13	11.42	9.65
Net (debt)/cash	-49,047	-34,551	-18.117	6.053	23.615	39.442
Shares issued (m)	112.7	112.7	113.3	114.4	115.0	115.0
P/E (x)	n/a	30.2	48.2	9.6	9.4	11.1
Dividend yield	n/a	n/a	n/a	n/a	5.8%	5.8%
FCF yield	n/a	12.4%	12.4%	17.8%	17.7%	18.9%

Source: Hardman & Co Research

Mining



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	**AAZ**
Price (p)	**83.50**
12m High (p)	97.0
12m Low (p)	35.3
Shares (m)	114.4
Mkt Cap (£m)	95.5
EV (£m)	89.4
Free Float*	58.95%
Market	AIM

**As defined by AIM Rule 26*

Description

AAZ operates three mines and downstream processing facilities at its main site at Gedabek in Azerbaijan. Besides further exploration potential at Gedabek, exploration work has begun at the 462 sq km prospect at Ordubad.

Company information

CEO	Reza Vaziri
CFO	Bill Morgan
Chairman	Khosrow Zamani

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Key shareholders

Directors & mgt.	41.05%

Diary

Apr'19	1Q production
May'19	2018 finals
Jul'19	2Q production
Sep'19	Interims

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Investment case

Production, resources and exploration

Gedabek is AAZ's flagship site, with three operating mines

AAZ's flagship Gedabek gold, silver and copper mining complex extends over 300 sq km and is located at the site of a former Siemens mine, which operated from 1864-1917. Currently, the company is operating three mines:

- **Gedabek open pit,** which has been producing gold, silver and copper since 2009;
- **Ugur open pit,** which was fast-tracked into gold and silver production in September 2017, following its discovery in October 2016; and
- **Gadir underground mine, which** has been producing gold since 2015.

Downstream processing has benefited from substantial investment

AAZ has invested significant capital and time in expanding and optimising its downstream processing facilities. The company is currently using four main processes in the production of gold dore and gold & copper concentrates:

- **heap leaching crushed ore** – cyanide irrigation on leach pads for gold dore;
- **SART** (sulphidisation, acidification, recycling and thickening) – recovers copper from cyanide solution for copper concentrate;
- **agitation leaching** – crushed ore is fed into a grinding circuit and agitated in cyanide solution for gold dore; and
- **flotation** – crushed ore is fed into a grinding circuit followed by the flotation circuit for copper and gold concentrates.

AAZ's production guidance for 2019 is 82,000-86,000 GEOs, compared with 2018 production of 83,736 oz (on guidance of 78,000-84,000 GEOs). We expect another year of more than 80,000 GEOs in 2020.

The hand-off in production from Ugur to Gedabek's open pit in 2021

Without an extension to the current resource at Ugur, there is the possibility of a step-down in AAZ's production in 2021 if the deposit is exhausted by the end of 2020. This is uncertain, however, as the Gedabek main pit should be able to pick up much of the slack. In September 2018, the company released its updated estimate of Mineral Reserves and Resources for Gedabek's open pit, as shown below. This showed gold resources of 986,000 oz and reserves of 343,000 oz.

Gedabek open pit – Mineral Resources & Reserves

	Tonnage	Gold k oz	Gold g/t	Silver oz	Silver g/t	Copper kt	Copper %
Measured	18.0	532	0.9	4,800	8.3	38.0	0.2
Indicated	11.1	264	0.7	2,011	5.6	15.7	0.1
M& I	29.1	796	0.9	6,811	7.3	53.7	0.2
Inferred	8.5	189	0.7	1,361	5.0	9.7	0.1
Total resources	37.6	986	0.8	8,172	6.8	63.4	0.2
Proved	10.9	311	0.9	3,084	8.8	31.9	0.3
Probable	1.2	32	0.8	373	9.5	4.1	0.3
Total reserves	12.1	343	0.9	3,457	8.9	36.0	0.3

Source: Hardman & Co Research

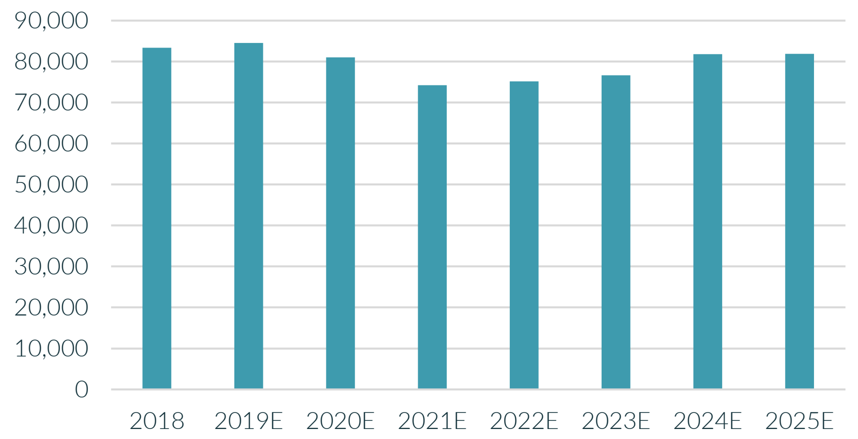
Gedabek open pit could fully compensate for lack of production at Ugur

The CEO of AAZ commented that the 343,000 oz of gold reserves delineated in the recent update would extend the life of Gedabek by another five to six years, implying annual production of 57,000-69,000 oz. Ugur produced about 50,000 oz of gold in 2018, versus almost 12,000 oz at the Gedabek open pit. Consequently, it is plausible that Gedabek's open pit could fully pick up the slack.

We are currently forecasting a modest dip in production below 80,000 GEOs during 2021-23

Currently, we are estimating AAZ's 2021 production at 74,240 GEOs, versus 81,064 in 2020, recovering to 81,800 by 2024. At this stage, given AAZ's valuation, there is no need to be anything other than conservative in our production estimates, as we develop our knowledge regarding the company's production prospects. The chart below shows our production forecasts through 2025 in terms of GEOs.

Anglo Asian Mining – production estimates, 2018-25 (GEOs)



Source: Hardman & Co Research

Current production forecast through 2025 is based on reserves, not resources

We are currently assuming that Gedabek's production lasts only through 2025. This is conservatively based on proved and probable reserves, rather than resources. It is worth noting that, when the gold production commenced at Gedabek in 2009, the mine plan at the time extended for six years. Furthermore, since late 2016, AAZ has been conducting an airborne geophysical survey to identify new drill targets and potential new mines (like Ugur) at the site. Exploration work has begun at the 462 sq km Ordubad site in Nakhchivan to identify porphyry-style copper-gold mineralisation.

Cash generation and valuation

AAZ is highly cash-generative and is in the first quartile of the industry

The outstanding aspect of AAZ's financial performance is the magnitude of cash generation. This is based on its low-cost production, due in part to its Azerbaijani jurisdiction, predominance of open pit mining, access to the national power grid, modest levels of reinvestment and investment in downstream processing. Its last reported (for 1H 2018) figure for All-In Sustaining Costs (AISC) was $543/oz, putting the company in the first quartile of the gold mining industry's cost curve.

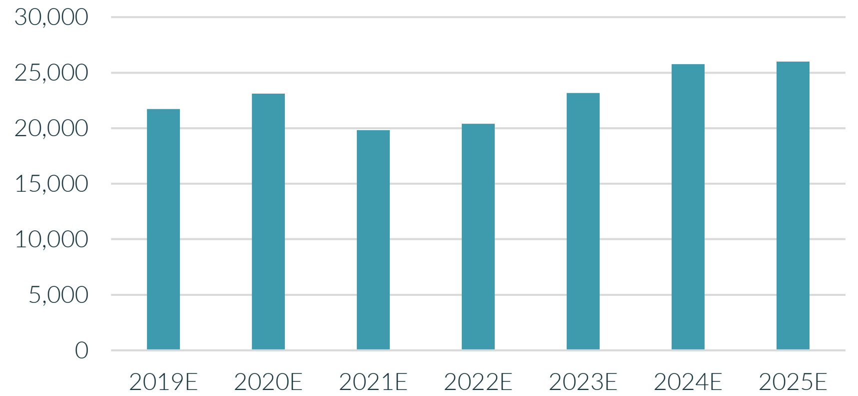
Balance sheet is net cash and company has started paying dividends

AAZ's strong cash generation saw it move into a net cash position in 2018 and enabled it to declare its maiden dividend of 0.03c/share with its 2018 interim results. We expect a similar final dividend to be announced with the 2018 full-year results in May 2019. The company has committed to paying a dividend equivalent to 25% of its free cashflow – defined as net cash flow from operations less capex – going forward. The balance sheet had net cash of $6.1m as at 31 December 2018.

We estimate that free cashflow generation, i.e. net profit plus depreciation and amortisation less capex, will average $22.9m p.a.

Last year, AAZ ran out of tax losses to offset against its tax liability. Nevertheless, we expect cash generation to remain strong during 2019-25, notwithstanding our conservative production assumptions. We estimate that annual free cashflow generation during 2019-25 will be in the range of $19.8m-$26.0m – with an average of $22.9m – versus AAZ's current market capitalisation of $116.6m (£95.5m). This amounts to an average free cashflow yield of 18.7% p.a.

Anglo Asian Mining – FCF estimates, 2019-25 ($m)



Source: Hardman & Co Research

DCF valuation, using 8% discount rate, is 146p per share

We have valued AAZ using a DCF model, incorporating a discount rate of 8%, production through to 2025, and gold, silver and copper prices of $1,300/oz, $16.00/oz and $6,000/tonne, respectively. Using these assumptions, our fair value for the company is 146 pence/share, versus the current price of 79.25 pence (as at 20 February 2018). Based on a total dividend of $0.06 per share for 2018, the shares are trading on a historical yield of 5.6%.

Jurisdiction and management

Well-established relationship with Government of Azerbaijan

The company is the only listed mining company in Azerbaijan and has a history of close cooperation with the Government of Azerbaijan (GoA), as well as links to the US establishment. Indeed, the GoA's Ministry of Emergencies provided helicopters for AAZ's recent airborne geophysical survey of the Gedabek area.

The company's President and CEO, Reza Vaziri, is founder and life chairman of the US Azerbaijan Chamber of Commerce. Vaziri was the head of Iran's foreign relations office prior to moving to the US. Chairman, Khosrow Zamani, was director of Europe & Central Asia for the International Finance Corporation, the World Bank's private-sector lending arm. Non-executive director, John Sununu, was George H. W. Bush's Chief of Staff. The CFO, Bill Morgan, previously worked as regional financial officer for Kinross in Russia and was CFO of AIM-listed gold miner, Hambledon Mining. Stephen Whitehead, Director of Geology, was formerly Technical Advisor to the M.D. of Polyus Gold's main business unit.

Effective royalty of 12.5% based on production-sharing agreement

Under the production-sharing agreement, GoA is entitled to 51% of "profit production", i.e. the value of production less cash operating and capital costs. The agreement is subject to a minimum of 25% of the 51%, i.e. 12.75%, until all costs are recovered. This has been the royalty rate every year; with $94.6m of unrecovered costs outstanding at end-2017, it is likely to remain so until at least 2023, according to the company. The production-sharing agreement is based on similar contracts to those that have been successfully used in the development of Azerbaijan's oil sector in cooperation with oil majors, such as BP.

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