Caledonia Mining Corporation

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"Genuine attempt to open up Zimbabwe for business": Caledonia Mining takes near-term hit against backdrop of improving outlook

Shares in Caledonia Mining Corporation PLC (LON:CMCL) took a bit of a dive at the end of February after the Zimbabwe government announced that it was ending its export credit incentive scheme.

Under the terms of this scheme, gold producers were able to secure a premium to the spot price by selling directly to a Zimbabwean government agency. The idea was that for a country starved of foreign exchange the government could get its hands on very valuable US dollars by selling the gold itself. In return, the gold companies booked their premiums, and everyone was happy.

Or so it was supposed to go.

It seems though that what ended up happening was that entrepreneurial criminals were smuggling gold or gold concentrate into Zimbabwe from elsewhere and then securing the premium by selling to foreign-produced metal to the government. The paradoxical effect was a net outflow rather than a net inflow of foreign exchange.

New Zimbabwean President Emerson Mnangagwa has promised to revitalise Zimbabwe's shattered economy, and addressing this issue was a high priority.

The negative effects on legitimate producers like Caledonia are seen by the government as a necessary cost to be borne on the road to economic normalisation.

That doesn't help Caledonia shareholders very much, given that the company estimated that the hit to earnings resulting from this change would amount to around US$5.4mln or between US$0.40 and US$0.46 per share.

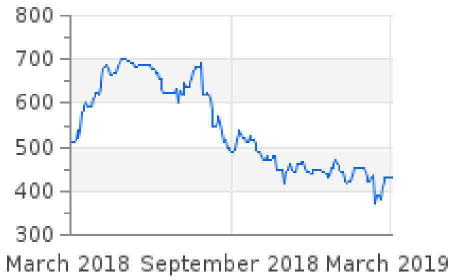
But beyond this immediate financial setback, there is actually some significant good news to tell.

The first item is that Zimbabwe's economic liberalisation is proceeding with gusto. It's not always been an easy process, to be sure, as the widespread unrest related to increased fuel prices bears witness to.

Price: 435p

Market Cap: £46.53M

1 Year Share Price Graph



Share Information

Code:		CMCL
Listing:		AIM
52 week	**High**	**Low**
	715.00p	**331.00p**
Sector:	**General Mining - Gold**	
Website:	**www.caledoniamining.com**	

Company Synopsis:
Caledonia is an exploration, development and mining company focused on Southern Africa. Caledonia's primary asset is a 49% interest in the Blanket Mine in Zimbabwe which produced 50,351 ounces of gold in 2016 at an All in Sustaining Cost of US$912/oz.

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But Mnangagwa has set out his stall, particularly on inflation, and there is widespread optimism in financial circles that the Reserve Bank of Zimbabwe is going to move towards a transparent currency market.

This is seen as key because real-terms inflation remains very high, but has until very recently been officially hidden behind a government-backed currency that has been kept at artificial levels.

Moves to address this issue with the creation of a newer freer-floating currency exchangeable on foreign markets have gone some way towards mitigating the problem, but the feeling is there is still some reserve bank intervention going on in the background, perhaps to allow the new currency a slower and more gentle move towards the true market rate.

This currency change is also related to the demise of the export credit incentive scheme, since the government has now created, in theory, its own currency capable of securing foreign exchange reserves, and no longer needs to rely on gold sales to secure US dollars.

The resolution of the currency complexities in Zimbabwe would be more than welcome, especially to workers at the operations like Caledonia's Blanket mine. By law Caledonia has had to pay its workers at the official rate, but with the twin currencies trading well off their official parity on the black market, that meant real-terms pay was cut to 14 cents in the dollar.

The disparity is no longer that extreme, but there is still some way to go.

Still, Caledonia's Mark Learmonth expresses cautious optimism that progress will be made. The company has met with Mr Mnangagwa and with the governor of the reserve bank and sees, he says, "a genuine attempt by the Zimbabwean government to liberalise the economy."

He points out that for the last four months the government has been running a surplus, which is virtually unheard of in the recent economic history of Zimbabwe.

"We are comfortable that there is a genuine attempt to open up the country for business," says Learmonth.

"We're very clear on that."

For Caledonia the upside could be significant. The hit from the cancellation of the export credit incentive will be a one-time event, but longer-term, the environment for deal-making is likely to improve.

Markets will become more transparent, and Caledonia's own arrangements for selling its gold will no longer be subject to arrangements of byzantine complexity designed to gerrymander foreign exchange into government coffers.

Plans for expansion at Blanket remain very much on track, and although grades have recently slipped, longer-term the 80,000 ounce target is likely to deliver a major boost to earnings. That in turn will allow Caledonia the flexibility to go after other assets with significant potential.

Indeed, the company has already started looking, although at this stage Learmonth is keen to emphasise that no major financial outlay is contemplated.

Instead the company will stick to its knitting, keeping its fingers crossed that the inflation problem will be brought under control, and freer in any case to sell its gold independently and out into the international markets.

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