Scotgold Resources Limited

14:17 09 Sep 2019

Scotgold Resources just six months away from gold production at Cononish, as the sterling gold price continues to hover around record highs

It's a truism in the mining industry that exploration companies, large or small, enjoy a re-rating as they move their projects closer and closer to production.

If such a re-rating is on the cards for Scotgold Resources Ltd (LON:SGZ), now less than six months away from production at its Cononish mine, there isn't much sign of it yet.

Partly, that's because extra finance has been required to mitigate delays in the construction of certain key buildings. But it's also because the idea of gold production in Scotland- or indeed anywhere in mainland Britain, is so alien it takes a little bit of getting used to.

It's real, though, as chief executive Richard Gray explains.

"We will be producing our first gold at the end of February," he says.

"We are currently developing and enlarging the existing adit so we can get our mechanised equipment in. We are getting the machinery over. And we are working on the buildings for the machinery."

It's those buildings which are behind schedule, due to civil engineering and design issues, but Scotgold has been able to mitigate some of the effects of the delay by creating a construction schedule that involves the installation of machinery concurrent with the building work.

First ore will be mined at the end of this year, and a small stockpile will be built up before the first gold comes out in February.

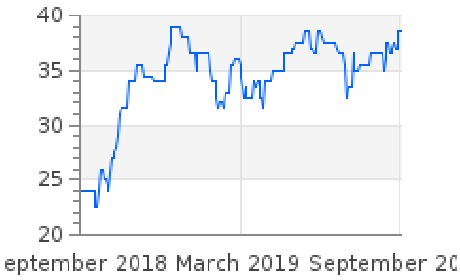
All, told, it's been a long time coming.

But actually, now that production is so close, it seems in some ways as if the timing couldn't be better.

Price: £0.38

Market Cap: £18.8 m

1 Year Share Price Graph



Share Information

Code:		SGZ
Listing:		AIM
52 week	**High**	**Low**
	43.5	**20.5**
Sector:		**Gold & silver**
Website		**www.scotgoldresources.com.au**

Company Synopsis:
Scotgold Resources Limited is a company that offers investors the opportunity to invest in the increasingly attractive gold mining industry through the development of the Cononish Mine in Scotland and exploration in Scotland and other low risk jurisdictions.

action@proactiveinvestors.com

That's because of the three way dynamic that operates between sterling, the dollar and the gold price.

Almost all of the operating costs at Cononish will be incurred in sterling, which is currently very weak against both the dollar and gold. That means that while the likely selling price of the gold that gets produced from Cononish will be high, the only pressure on costs will be downward.

It's a nice problem to have, and Scotgold illustrated its effects clearly in its latest market release.

According to the Scotgold number-crunchers if the sterling gold price stands at £920 per ounce, then the Cononish mine is likely to generate just over £101mln in earnings over its ten year life, with net cashflow of just over £68mln and a net margin of 59%.

Nice enough if you can get it. But wait: boost the sterling gold price to £1,200 per ounce and the numbers improve dramatically. In this scenario earnings jump by more than 45% to £146mln, with cash flow also significantly better at more than £97mln, and net margin boosted to 66%.

Of course, it's hard to say what the long-term average gold price is likely to be over the next ten years or so, but with the current sterling price pushing beyond £1,250 per ounce even this second scenario starts to look conservative.

So, the case for a re-rating is certainly there to be made: the completion of construction is just a matter of months away, the currency stars are aligned for a handsome economic return, and funding risk is a thing of the past because the latest £2.5mln fundraising from the company will take it all the way into production.

It will also go a long way towards financing a planned second phase too. The rest of that second phase will be paid for by the cashflow which ought to be well established by this time next year.

"We expect to be generating about £1mln per month," says Gray.

All that's left is execution risk, and that's dropping away by the day. It's in these scenarios that investors begin to get twitchy, wondering when and whether to hit the bid before everybody else does.

In the case of Scotgold there is a catch, though. Liquidity isn't that great because the major shareholder Nat LeRoux, who has backed the company all the way, now holds just under 50% of the shares, while three other shareholders account for a further 20%.

That could go both ways if the market suddenly gets a taste for Scotgold. It could mean that punters get frustrated and give up trying. Or it could mean that because there's precious little of the equity around the price gets driven way up.

One things for sure, in a strong gold price environment gold mining equities outperform the gold price, and there's no reason why Scotgold should be an exception. Especially since the gold that comes from Cononish will be branded Scottish and could command a premium of up to 25%.

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