



Evolutionary zeal

Cost cuts, aided by a weaker dollar, have transformed a goldminer's fortunes, writes Roger Montgomery

A T MONTGOMERY WE ONLY follow businesses that meet our criteria – that have superior financial positions and performances, offer bright prospects and have share prices that are selling at a discount to our assessment of intrinsic values.

I thought I would go “off piste” and review a gold stock going through a positive transformation, Evolution Mining (ASX: EVN). Executive chairman Jake Klein is a “gold entrepreneur” with an impressive history, having built up the China-based (ASX-listed) Sino Gold Mining before selling out to British Columbian Eldorado Gold in 2009 for \$2.2 billion.

After getting a number of the members of the band back together, Klein has built Evolution to a business producing an estimated 425,000 ounces of gold annually. At \$1.13 a share at the time of writing, the company is now capitalised at more than \$800 million, up from \$315 million in late 2014.

Evolution owns 100% of five relatively mature high-cost mines: Mt Carlton, Mt Rawdon, Cracow and Pajingo in Queensland and Edna May in Western Australia. Chief operating officer Mark Le Messurier and the leadership team have done a fine job over the past two years in cutting the cash cost of production, before royalties and after byproduct credits, by 9% from \$790/oz to \$718/oz.

A lot of investors seem to be missing the recent fall in the cash cost of production, translated into US dollars, with respect to the Aussie gold sector. With the 22% decline of the Australian dollar from \$US1.025 to sub-US80¢, Evolution's US dollar cash cost of production has fallen nearly 30% from \$US810/oz to \$US575/oz over the past two years.

It was no great surprise then that in the March 2015 quarter, when the gold priced averaged \$US1180/oz, Evolution produced



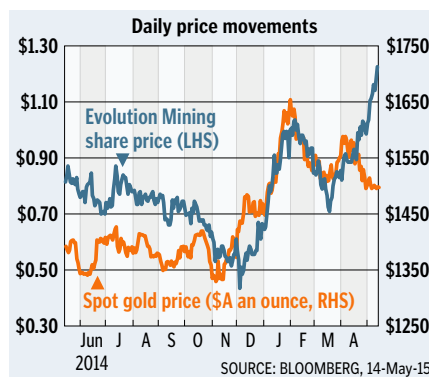
add 130,000-160,000 annual ounces, taking combined production in the year to June 2016 to around 570,000 ounces (+34%). Gold reserves will increase 31% to 3.4 million ounces and gold resources will increase 47% to 8.4 million ounces while earnings and revenue margins are expected to increase by 2% to 44%.

Evolution shares on issue will jump from 716.7 million to 1.0387 billion, and its net debt will increase to \$163 million. At \$1.13 a share, the company has a theoretical market capitalisation of \$1.173 billion and an enterprise value of \$1.337 billion. The Sawiris will control 31% of the company's increased issued capital (and two of nine board seats). Furthermore, they have potentially made \$100 million in additional capital available to Evolution, if required.

Evolution has, for \$9 million, or an average 8.5¢ a share, also recently acquired 20% of Phoenix Gold (PXG), which covers a significant strike length of the highly prospective Zuleika Shear and Kunanalling Shear, just north of Frog's Leg and White Foil. Phoenix will spend at least \$5 million on exploration, supporting Evolution's claim that it is “using science and technology to improve the probability of transformational discoveries”.

While Montgomery Investment Management doesn't generally troll for resource companies, Evolution ticks a number of boxes: increased production, reserves and resource and estimated earnings margins; and it also enjoying a dramatic reduction in cash costs. It looks to me that Klein is well on the way to putting together another “Sino Gold” and I'm sure Eldorado, Barrick or another large global producer will come calling at some stage.

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a record quarterly free cash flow of \$27 million. And the company repaid \$35 million in debt, reducing its net debt at the end of March 2015 to \$60 million.

Klein takes a portfolio approach to the company's mines and, in a recently announced deal, Evolution will acquire 100% of the La Mancha Australian assets from the multibillionaire Egyptian-based Sawiris family, owners of the Orascom Group. The Frog's Leg and White Foil mines west of Kalgoorlie in WA will