

Spec. buy

Current Price \$0.99
Valuation \$1.29

Code: **DEG**
Sector: **Materials**

* All figures in AUD unless stated otherwise

Shares on Issue (M):	1,288
Market Cap (\$M):	1,275
Net cash (\$M Sep 2020, post raise)	115
Enterprise value (\$M):	1,197
52 wk High/Low (ps):	\$1.55 \$0.05
12m av. daily vol. (Mshs):	12.23

Key Metrics

	FY24e	FY25e	FY26e
P/E (x)	9.9	5.2	5.2
EV/EBITDA (x)	6.6	3.2	3.2

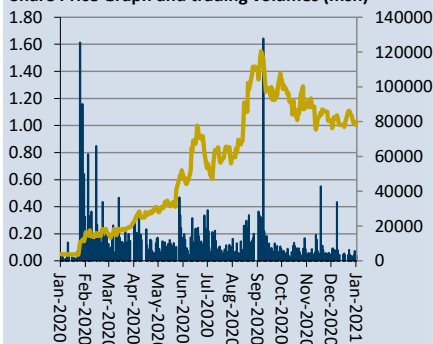
Financials:

	FY24e	FY25e	FY26e
Revenue (\$M)	342	684	684
EBIT (\$M)	164	312	310
NPAT (A\$M)	129	247	246
Net assets (\$M)	492	719	948
Op CF (\$M)	163	304	305

Per share data:

EPS (c)	10.0	19.2	19.1
Dividend (cps)	0.0	0.0	0.0
Yield (%)	-	-	-
CF/Share (cps)	12.6	23.6	23.7
Prod (koz Au)	140.8	281.5	281.5

Share Price Graph and trading volumes (msh)



Please refer to important disclosures at end of the report (from page 7)

Friday, 15 January 2021

De Grey Mining Ltd (DEG)

Mallina; work in progress

John Macdonald

Quick Read

On our early sums, exposure to De Grey's 2021 exploration push comes almost for free.

Main points

First stab at Hemi: Based on our analysis of reported drill data to mid-January 2021, and without assuming more discoveries, Argonaut estimates 3-4Mozs at Hemi in the top 250m from surface. As a starting presumption we use 60Mt at 1.5 g/t (3.0Mozs) and a 4:1 waste:ore ratio, as a Hemi mine inventory in our model. We also presume 18Mt at 1.6 g/t in satellite pit mine inventories, mostly drawn from measured and indicated resources estimated by De Grey. The Company is stepping up drilling activity with the aim of identifying more mineralisation in the Hemi area before estimating resources in mid 2021.

Conventional refractory ore process: Subject to completion of testing, the Mallina gold project is likely to be developed with conventional ore processing methods, including pressure oxidation. While there are few good cost benchmarks for the size and type of pressure oxidation circuit being considered by De Grey, capital and operating costs are unlikely to be prohibitive. Metallurgical recovery of 90-96% appears achievable. Argonaut models a 6Mtpa operation producing 280kozspa.

Exploration: Hemi forms a new locus of gold mineralisation in the Archaean Pilbara. Larger than previous finds in the belt, and interpreted as a sanukitoid (intrusion) related gold system in contrast to the shear hosted deposits targeted in the past, Hemi opens up the belt's apparent exploration potential. De Grey is the dominant tenement holder over 150km of prospective Pilbara geology.

De Grey has eight drill rigs drilling at Hemi in support of a resource estimate in mid-2021. Aircore drilling and follow up RC drilling continues in the greater Hemi area, testing intrusion prospects at Scooby, Shaggy, Antwerp and Alectroenas. The first aircore drilling of regional intrusions identified at Charity Well, Calvert and Geemas, will start in the first half of 2021. The Company is in the early stages of understanding the gold distribution and endowment in the Pilbara. More discoveries seem likely.

Recommendation

Argonaut's first DCF based valuation of De Grey shares returns \$1.29 per share without heavy reliance on further exploration success. Forecasts are necessarily broad brush at this early stage, however the exercise provides some pricing backstop while the main game of drilling continues through 2021. Speculative buy.

De Grey Mining

Equities Research

Analyst: John Macdonald

Recommendation Speculative buy
Current Price \$0.99
Valuation \$1.29

Sector Metals & Mining
Issued Capital (Mshs) 1,288
Market Cap (M) \$1,278
Friday, 15 January 2021

Profit & loss (\$M) 30 June	2021E	2022E	2023E	2024E
Sales Revenue	0	0	0	342
+ Other income/forwards	0	0	0	0
- Operating costs	0	0	0	-138
- Royalties	0	0	0	-14
- Corporate & administration	-9	-9	-9	-9
Total Costs	-9	-9	-9	-161
EBITDA	-9	-9	-9	181
- margin	0%	0%	0%	53%
- D&A	0	0	0	-17
EBIT	-9	-9	-9	164
+ Finance Income/Expense	0	0	0	-3
PBT	-9	-9	-9	161
- Tax expense	2	1	2	-32
- Impairments and other				
NPAT	-7	-8	-7	129

Cash flow (\$M)	2021E	2022E	2023E	2024E
+ Revenue	0	0	0	342
- Cash costs	-9	-9	-9	-161
- Forwards	0	0	0	0
-Tax payments		0	0	-15
+ Interest & other	0	0	0	-3
Operating activities	-9	-8	-9	163
- Property, plant, mine devel.	0	-31	-301	-354
- Exploration	-32	-32	-32	-20
Investment activities	-32	-63	-333	-374
+ Borrowings	0	0	100	300
- Dividends	0	0	0	0
+ Equity	103	1	270	0
Financing activities	103	1	370	300
Cash change	62	-70	28	89

Balance sheet	2021E	2022E	2023E	2024E
Cash & bullion	90	21	49	138
Other Current Assets	0	0	0	0
Total current assets	90	21	49	138
Property, plant & equip.	50	81	382	719
Investments/other	0	0	0	0
Total non-curr. assets	50	81	382	719
Total assets	140	101	430	857
Trade payables	5	10	5	42
Short term borrowings	0	0	0	120
Other	5	5	80	42
Total curr. liabilities	10	15	85	84
Long term borrowings	0	0	100	280
Other	0	0	0	0
Total non-curr. liabil.	0	0	100	280
Total liabilities	10	15	185	364
Net assets	130	86	245	492

Shares	2021E	2022E	2023E	2024E
New shs issued/exerciseable	118	4	201	0
Average issue price	0.88	0.35	1.35	0.00
Ordinary shares - end	1291	1294	1495	1495
Diluted shares - end	1295	1295	1495	1495

Financial ratios		2024E	2025E	2026E	2027E
GCFPS	Ac	12.6	23.6	23.7	23.7
CFR	X	7.8	4.2	4.2	4.2
EPS	Ac	10.0	19.2	19.1	19.1
PER	X	9.9	5.2	5.2	5.2
DPS	Ac	0.0	0.1	0.1	0.1
Yield	%	0.0%	5.0%	5.0%	5.0%
Interest cover	x	50.6	88.0	132.0	267.9
ROCE	%	23%	47%	50%	54%
ROE	%	33%	48%	39%	37%
Gearing	%	57%	25%	5%	5%

Operations summary	2024E	2025E	2026E	2027E
Pilbara project				
Ore processed (Mt)	3.0	6.0	6.0	6.0
Head grade (g/t)	1.52	1.52	1.52	1.52
Met. recovery	0.96	0.96	0.96	0.96
Gold prodn (koz)	141	282	282	282
Cost per milled tonne (A\$/t)	46	46	47	47
Cash costs pre royalty (A\$/oz)	1081	1084	1089	1094
Sustaining capital (\$M)	0	0	0	0
All in sustaining costs (A\$/oz)	1178	1181	1186	1191
Growth capital (\$M)	354	7	8	7
CAIC (A\$/oz)	3932	1441	1439	1437

Price assumptions	2024E	2025E	2026E	2027E
AUDUSD	0.72	0.72	0.72	0.72
Gold	1750	1750	1750	1750

Valuation summary	A\$M	A\$/sh
Mallina project 7% real after tax DR	1301	1.01
Exploration, all sites	325	0.25
Corporate overheads	-46	-0.04
Cash and bullion	115	0.09
Debt	0	0.00
Tax benefit	10	0.01
Hedging	0	0.00
Option/equity dilution	-39	-0.03
NAV	1,666	1.29

Directors, management	
Simon Lill	Non-Executive Chairman
Glenn Jardine	Managing Director
Andy Beckwith	Executive Director
Peter Hood	Non-Executive Director
Ed Eshuys	Non-Executive Director
Bruce Parcutt	Non-Executive Director

Top shareholders	M shs	%
DGO Gold Limited	193.0	15.0
Van Eck	65.0	5.0
Northwest Nonferrous	51.0	4.0

Resources June '20	Mt	g/t Au	Kozs	Mkt cap/oz
Pilbara gold project	37.4	1.80	2,163	591
Measured & indicated	18.9	1.70	1,033	
Inferred	18.5	1.90	1,130	

Argonaut model Dec '20	Mt	g/t Au	Kozs	
TOTAL INVENTORY	78.0	1.52	3,820	335
Hemi open pit	60.0	1.50	2,894	
Satellite open pit	18.0	1.60	926	

Mallina gold project - size and scope

As of January 13 2021, De Grey had reported assays from about 300 holes (80,000m) drilled at the Brolga, Aquila, Crow and Falcon zones (Hemi). Most of the drilling has been completed to 80m by 40m spacing, with a handful of holes penetrating to 600m vertical depth. Infill and extensional drilling are ongoing with the aim of estimating a resource in mid-2021.

Sufficient data is available for Argonaut to estimate the scale of the inventory uncovered so far at Hemi. Based on assay and collar data we estimate a work in progress inventory of 3-4 million ounces in the top 250m from surface. Our estimate lacks downhole surveys, density details, geological control, and the complete data set, hence the broad range. Up to 30% of the inventory could be oxide and transitional material. Our presumptions will be revised as more data becomes available.

Prior to the discoveries at Hemi, De Grey estimated total measured, indicated and inferred Mallina gold project resources at 37Mt at 1.8 g/t (2.2Mozs), within 12 separate deposits ranging 10-60km from Hemi. The measured and indicated pit component of resources is 19Mt at 1.6 g/t (1.0Mozs), divided 46% oxide, 54% sulphide. Most of the measured and indicated pit resources are estimated for Withnell (240koz), Toweranna (293koz), and Wingina (216koz). Assuming not all of the measured and indicated resources will convert to reserves, and some of the inferred resources will contribute with further drilling, we add 1Mozs to our model for satellite sources, with the extra trucking costs included.

Presuming development

De Grey and its predecessors have been operating in the belt for many years. De Grey's March 2020 resource estimate includes 12 separate deposits found over 120km of east west geology. Resources are designated oxide and fresh. In February 2019, prior to Hemi's discovery, GR Engineering designed and costed a 2Mtpa plant for the Mallina gold project, incorporating flotation, pressure oxidation (POX), and CIL processing (the costings are not available). The discoveries at Hemi have since lifted the potential scale of the development proposal. The basic process flowsheet will likely be retained.

Subject to further tests of representative samples, De Grey has indicated 10% mass pull for 92% flotation recovery (96% total recovery). Average 10% mass pull suggests a pressure oxidation circuit treating 7-10% of the crushed and milled ore, allowing for a proportion of direct CIL feed. We presume 78Mt at 1.5 g/t (3.8Mozs) as a starting point mine inventory, a 6Mtpa ore treatment operation, and 450ktpa of concentrate destined for pressure oxidation

Without many relevant yardsticks, we assume capital costs of A\$500-800M (A\$650M mid-point) for a 6Mtpa Pilbara Project operation. Operating costs will be higher than for equivalent straight CIL, but not necessarily by much. We assume \$25/t ore processing costs.

Pressure oxidation (POX)

While more capital intensive than alternatives, POX technology is often the most efficient process solution for refractory gold ores, and the most environmentally acceptable.

In pressure oxidation circuits, the sulphides in which the gold is locked are oxidised in a reaction chamber (autoclave). The autoclave typically operates at +190°C and 2,000 kPa with a retention time of 30 – 60 minutes. POX circuits can operate on whole ore and/or flotation concentrates. Better than 90% gold recovery to a flotation concentrate usually justifies a float circuit rather than whole ore POX. The higher the recovery of gold to concentrate and the smaller the mass pull, the smaller the required pressure oxidation plant and throughput rate. For concentrate POX, autogenous autoclave reactions reduce energy needs. Acid produced by sulphide oxidation must be neutralised with lime or limestone, at a cost. Tailings disposal design must negate the potential for acid generation and arsenic mobility.

In terms of concentrate pressure oxidation, our assumed 450ktpa for the Pilbara project would be larger capacity than currently installed elsewhere. Porgera operated at about 400ktpa from 1991. Polymetal is installing 250-300ktpa circuit at Amursk POX2, using a single 50m long autoclave. The reported capital cost of Amursk POX2, for a relatively high temperature, high pressure circuit, is US\$430M.

The Macraes gold mine (operated by Oceana Gold) uses POX of a float concentrate. Macraes has a mass pull of 2.5% from 4-6Mtpa crushed and milled (120ktpa POX). The flotation tailings do not undergo CIL treatment. The concentrate is ultrafine ground to 80% passing 13 microns before CIL. Total processing costs are NZ\$10.70/t ore, assisted by a power cost of NZc9/kWh. The float recovery is 86%, CIL 95% for total of 82% recovery.

At the Copley gold mine in Turkey (operated by SSR Mining) a relatively high mass pull of 25%, containing 70% of the gold, initially precluded flotation concentration. The project was set up on whole ore POX, and modified in 2019 to partial flotation, part direct ore POX with a sulphide ore capacity of 2.8Mtpa. Total recovery is 98%. Processing costs of US\$34/t of ore lead to use of a 1.05 g/t cut-off on sulphide material.

De Grey metallurgical test-work

In early 2020 four composite samples were obtained from two diamond drill holes at Brolga, including one of transition material and three of fresh ore. All were assessed for gold recovered to a flotation concentrate. The primary finding was that, in the fresh samples, flotation recovered 92.5% of the gold into a concentrate containing 7.5-9.4% by weight of the feed. A secondary finding was that cyanidation of the float tail recovered 60-67% of the gold in the tails. Finally, pressure oxidation and cyanidation of the one flotation concentrate sample tested, recovered 99% of the gold in concentrate. Overall recovery of 96.3% was returned from the one fully tested composite sample.

While De Grey's tests of Brolga material reported in July 2020 are limited in scope and not necessarily representative, they point to a process design including flotation-pressure oxidation, and cyanidation of both the concentrate and the concentrate tails, and +90% total recovery. Prior to the discoveries at Hemi, De Grey was considering 50-100ktpa POX with Withnell sulphide ore as base load feed (90% total recovery, 9% mass pull). Withnell is 30km from Hemi and will now form a satellite proposal to Hemi.

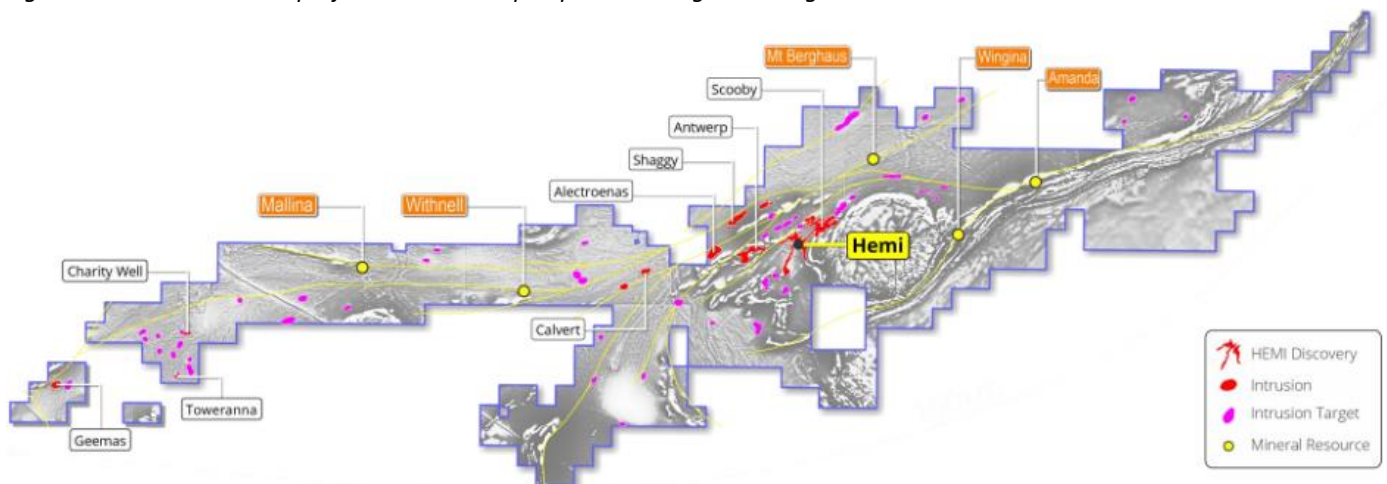
Hemi has significant oxide and transition components amenable to direct cyanidation. Depth of oxidation is typically 80-100m, suggesting up to 30-40% of mineralised material discovered so far at Hemi could be direct CIL feed rather than POX. Mt Berghaus and Wingina (10-20km from Hemi) have estimated M&I oxide resources of 240kcozs (1.7g/t). Withnell has an oxide component of 45kcozs, M&I. Mallina (45km from Hemi) has 30kcozs oxide M&I resources (1.3 g/t). Toweranna's 290kcozs M&I (4.3Mt at 2.1 g/t Au open pit, 60km from Hemi) was assessed in mid-2019 as free milling. Based on the prevalence of oxide and free milling ores throughout the project we assume 25% of the mine inventory is direct CIL feed.

Exploration

Hemi forms a new locus of gold mineralisation in the Archaean Pilbara. Larger than previous finds in the belt, and interpreted as a sanukitoid (intrusion) related gold system, in contrast to the shear hosted deposits targeted in the past, Hemi opens up the belt's apparent exploration potential.

De Grey has eight drill rigs (3 RC, 3 diamond and 2 aircore) drilling at Hemi and surrounds in early 2021. Objectives include a resource estimate in mid-2021. Aircore drilling and follow up RC drilling continues in the greater Hemi area, testing intrusion prospects at Scooby, Shaggy, Antwerp and Alectroenas. The first aircore drilling of regional intrusions identified at Charity Well, Calvert and Geemas, will start in the first half of 2021

Fig. 1: Mallina Gold project. Tenure and prospects on magnetic image.



Source: De Grey

Valuation

The valuation is based on a discounted cash flow valuation of the Mallina project, and an informal estimate of exploration assets value and nominal assessment of De Grey's other assets and liabilities, as at December 2020. Argonaut's modelled pit inventory is 78Mt at 1.5 g/t, comprising 60Mt at 1.5 g/t at Hemi and 18Mt at 1.6 g/t in satellite pits, including but not restricted to Toweranna, Withnell, Wingina and Mallina. Waste:ore of 4:1 is assumed for all pits. Earth moving rates of \$9-10/bcm material are used. Ore trucking costs of 12c/t/km are included. Resource/reserve drilling and evaluation costs of \$30M

and other pre-production capital costs of A\$650M are assumed. Site administration costs and ore processing costs are estimated at \$10Mpa and \$25/t ore respectively. An estimate of the NPV of corporate overhead costs is included in the valuation. A real, after tax discount rate of 7% is used. Future tax benefits are added back as an estimate of present value. Argonaut's base case commodity and currency forecasts, set out in the summary table, are used to estimate the base case NAV.

Fig. 2: Valuation summary

Valuation summary	A\$M	A\$/sh
Mallina project 7% real after tax DR	1301	1.01
Exploration, all sites	325	0.25
Corporate overheads	-46	-0.04
Cash and bullion	115	0.09
Debt	0	0.00
Tax benefit	10	0.01
Hedging	0	0.00
Option/equity dilution	-39	-0.03
NAV	1,666	1.29

Source: Argonaut research

Key risks to valuation

Mineable inventory

Argonaut's estimates of mineable inventories at Mallina are based on incomplete information, subjective calls on future drilling, and pre-emption of De Grey's development decisions. A 10% change in total ore tonnes (+/-8Mt at 1.5g/t) changes the De Grey valuation by 7-8%.

Metallurgy

De Grey's early tests indicate high rates of recovery using conventional processes.

Gold price

Our estimates of De Grey cash flows are sensitive to the gold price. Each 10% change in the Australian dollar gold price changes our valuation by 20%.

Costs.

Cost assumptions are based on incomplete information or informal estimates. Operating and capital costs assumptions rely on our knowledge of industry rates. There are few relevant yardsticks for POX circuit operating and capital costs, so risks are higher than for most gold projects.

Exploration success

De Grey may invest its cash and any future free cash flows in exploration and/or other mineral asset acquisitions. Valuation assumes that future exploration and investments achieve acceptable returns. Subjective value is attributed to exploration assets at Mallina.

Interest rates/discount rates

Argonaut takes cash flow risk into account when choosing discount rates for different projects. Our valuation is sensitive to the discount rate used. A 2% change in the (after tax) discount rate makes a 16-20% difference to our De Grey valuation.

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Argonaut acted as Joint Lead Manager in respect of the Placement that raised \$31.2M in April 2020 and received fees commensurate with this service. Argonaut acted as Joint Lead Manager in respect of the Placement to raise up to \$103.2 and Senior Management SellDown in September 2020 and received fees commensurate with this service.

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