Petropavlovsk PLC

Refinanced and Ready to Go

POG LN

16 July 2019

Last price: 9.65p
Target price: 16p

Upgrading Target Price: 16p

We have adjusted our financial model post a site visit to the company's recently commissioned POX plant and mining operations in Amur.

2019 is proving to be a good year for Petropavlovsk: the gold price has broken US$1,400/oz and is at a c.2.5 year high in Rouble terms, the POX plant appears to be performing well, and likewise IRC (notwithstanding the product hedge recently announced). Importantly the company has rolled its convertible forward and management appear settled. The share price has reacted accordingly for one of the most leveraged gold companies in the market, rising 54.3% YTD, making it the best performing gold stock on the FTSE. Our updated model delivers an NPV 10% of US$519 million or 16p/share.

We forecast EBITDA for 2019 and 2020 of US$205 million and US$276 million, (at US$1,350/oz) and leaves the stock trading at EV/EBITDA 4.8x 2019 and 3.6x in 2020. We lift our price target to 16p/share.

POX Commissioned

The successful commissioning of the POX plant underpins an engine room of 450koz to 500koz of direct production. However, the success of the flotation plant at Malomir in producing higher grade material than had originally been anticipated in the design of the plant means there is spare capacity, which it is now filling with third party concentrate.

The company is also accelerating development of the flotation plant at Pioneer and further underground discoveries may lead to more high-grade, non-refractory ounces. We also believe that the POX plant will be a catalyst for consolidation eventually.

A recent site visit showed well organised operations, and a clear path to profitability that had been missing in previous years.

Convertible Refinanced

Petropavlovsk recently announced the refinancing of their US$100 million convertible notes through the placement of new US$125 million convertible bonds due 2024. The new bond both gives the cash required to repurchase the convertibles and to allocate capital to the float plant at Pioneer. Positively, the company has shown flexibility in managing cash requirements – e.g. through the existing gold prepayment facility.

IRC turning into a positive asset for the company

The share price of IRC is also up, 341% this year, mainly due to the rise in iron ore prices. Petropavlovsk's 31.1% stake in the company is worth US$59 million. IRC has reported its K&S mine operated at 93% of capacity in the month of June, although it also reported it hedged a proportion of production pre the recent iron ore price rise.

Overall, we believe the IRC stake is not accorded any valuation by the market and if sold would be a major catalyst for the Petropavlovsk share price.

Valuation

We value Petropavlovsk using a discount cashflow methodology, making adjustments for debt, working capital (including the gold forward sales) and corporate costs. Our valuation for the company is 16p/share at a US$1,350 gold price – rising to 0.20p/share at the spot gold price of US$1,413/oz. At our target price of 16p, the shares would be trading at 6.1x 2019E EV/EBITDA (vs Polymetal for instance which is currently trading on 6.9x 2019E EV/EBITDA).

Analysts: David Butler, David Baker

Summary

Last price:	9.65p
Target price (GBp)	16p
Projected return (%)	66%

Project Details

Project name	Amur Region
Commodity	Gold
Production (koz Au)	c.500
Operating $NPV_{10\%}$ (US$m)	1,554
Company $NAV_{10\%}$ (US$m)	649

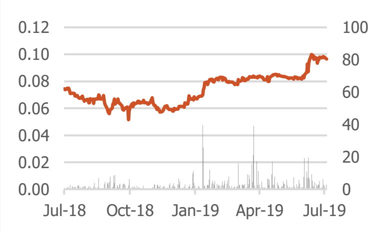
Share Data

Shares o/s* (mm)	3,302
52 week high/low (GBP)	0.05 / 0.10
3-mth avg. daily vol (mm)	5.0
3-mth avg. daily vol (GBPm)	0.4
Market cap (US$m)	398
Net cash/(debt) (US$m)	(596)
Enterprise value (US$m)	995

(US$m)

Financial Data	2018	2019	2020
Revenue	500	642	675
EBITDA	143	205	276
Net income	26	(9)	66
EPS	0.01	(0.01)	0.02
P/E	15.4	-	6.0
EV/EBITDA	7.0	4.8	3.6

Share Price Performance



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Introduction

Most of this note is dedicated to reporting on a site visit conducted last month and our subsequent valuation update. However, whilst on the site visit, the company announced the refinancing of the US$100 million convertible bonds due 2020 with a new US$125 million convertible bond due 2024.

The additional capital will be used to accelerate the development of the flotation plant at Pioneer – a very positive development for the company.

We summarise our new financials in the table below:

Figure 1 – Summary Financials

	2017A	2018A	2019E	2020E	2021E
Sales Revenue	587	500	642	675	704
Operating Costs	(511)	(389)	(534)	(492)	(501)
Gross Profit	**112**	**127**	**108**	**184**	**203**
Interest expense	(25)	(26)	(68)	(55)	(52)
Other expenses	(26)	(18)	-	-	-
PBT	**61**	**82**	**40**	**131**	**151**
Taxation	(19)	(56)	(49)	(63)	(69)
NPAT	**41**	**26**	**(9)**	**66**	**82**
EBITDA	197	143	205	276	305

Source: Tamesis

POX up and running – essential refinancing completed

Tamesis recently visited three Petropavlovsk operations in Amur Oblast, Russia. Access to site was through helicopter from Blagoveshchensk airport which offers direct flights from Moscow. Our site visit was focused on the two flotation lines at Malomir, which produce refractory concentrate for the POX hub at the old Pokrovsky mine. The POX hub currently has two out of four autoclaves operating at full capacity, awaiting delivery of critical parts to bring all autoclaves online.

Additionally we visited the Pioneer mine and viewed the site for the now funded flotation plant. We expect the new flotation plant to be built to the same high standards as at Malomir.

Figure 2 – Operating Autoclaves at the POX hub

Source: Tamesis

Malomir

Refractory Operations (Open Pit + Flotation)

The Malomir open pit is currently split in two, with an access road crossing the saddle. Now that refractory ores can be processed through the flotation plant, the overall pit will be optimised into a 800m x 3.2km pit, with the deposit dipping shallowly to the west.

It was evident that strip ratios will be low over life of mine, and it was clear how mining costs could be kept low (c.Rub180/bcm – approximately US$2.84/bcm or US$1.1/t). We observed overburden being mined and moved a short distance to the dumps using the 90t Cat 777 fleet.

RoM ore was being moved in smaller 30t trucks with direct access via a single ramp to the haul road from the pit with no switchbacks.

Figure 3 –Malomir Open Pit

Source: Tamesis

After the crushing and grinding circuit, Malomir has two identical float lines in operation, right sized for the 3.6Mtpa crush and grind capacity, producing up to 230ktpa of refractory ore concentrate.

The plant has been in commercial production since Q3/2018 and recoveries have been in-line or exceeding design capacity.

Designed and commissioned by Outotech from Finland, the plant is nearly completely automated. At the time of the visit there were only a small number of manual adjustments to reagent volumes that are required in the process – these will be upgraded to fully automatic processes in the coming months with lower future labour requirements.

One key issue the plant has had to deal with is the presence of organic carbon, which impacts the float. Positively, the carbon is typically associated with higher grade ores.

Mitigating this issue is a reagent that can be used to suppress the carbon that was developed by the company's in-house laboratories; a key breakthrough in the whole POX chain.

Figure 4 – Flotation lines at Malomir

Source: Tamesis

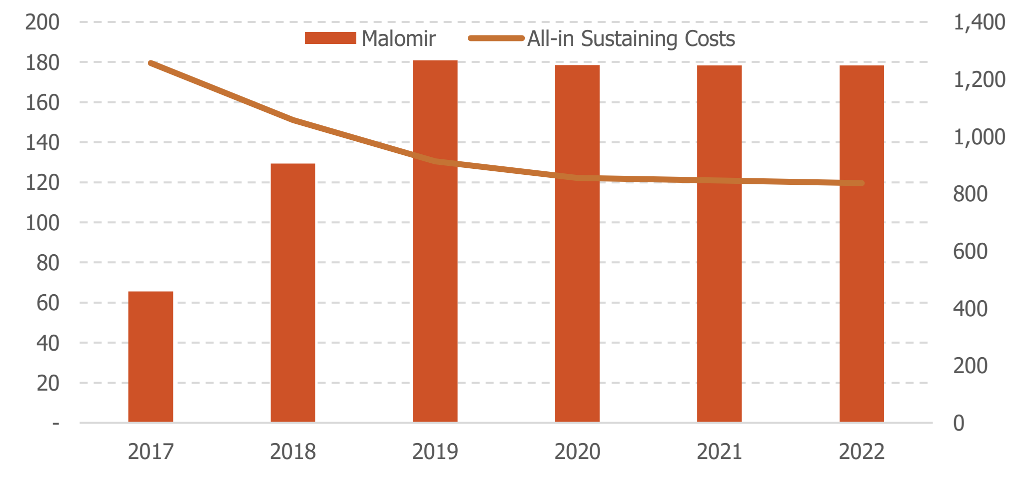
Non-Refractory Operations (Underground)

We visited the underground portal at the Quartzitovoye satellite pit where Petropavlovsk are mining c.20ktpa of high-grade non-refractory ore, currently averaging 8g/t. Mining currently is taking place to a depth of 150 metres and they are 2 years into the current 4 year plan. Processing takes place at the 3rd crushing and grind circuit which has capacity of c.400ktpa, the slurry is then processed with the existing RIP plant.

There is certainly the potential for underground mine life expansion at Quartzitovoye. Exploration drilling is expected to identify new stopes, but the longer term potential is limited – the current geological interpretation is that grades and widths are lower at depth.

There are other drill ready targets, but these are outside the existing Malomir main pit and the two satellite pits. The mine geologists suggested that the prospect for near surface refractory material was more exciting than high-grade non-refractory discoveries

Figure 5 – Malomir Production



Source: Tamesis

POX Hub at Pokrovskiy

Starting at the loading facility, we saw 20kt of concentrate in bags from Malomir ready for processing. Additionally, we saw the first batch of 3rd party concentrate which was sourced from a Kazakhstan operation. This concentrate, grading 43g/t, has a high chloride content.

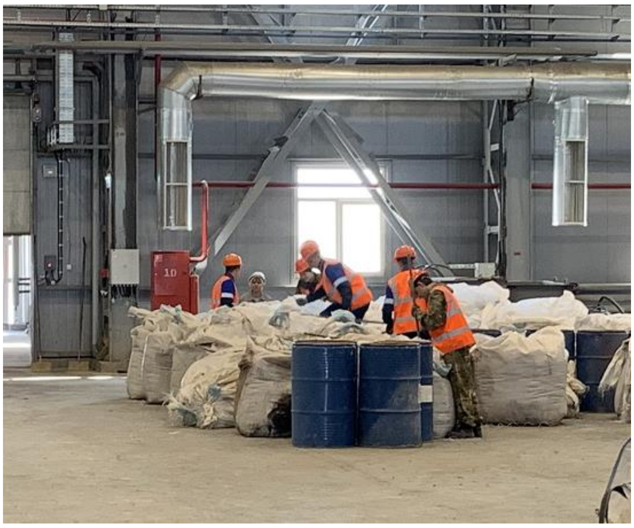
Processing the first batch of 3rd party concentrate is expected to take place in July, where a full autoclave line will be dedicated to the material. We are looking forward to seeing how this concentrate performs.

However, it is definitely positive to see that the thesis for using the spare capacity at the POX hub is now being executed, with concentrate sourced over 5000km away.

The next batch of concentrate is sourced from Polyus, grading 60-80g/t with low deleterious elements and is expected to perform well

Figure 6 – Bagged Malomir Concentrate at the POX Hub

Figure 7 – Third Party Concentrate at the POX Hub



Source: Tamesis

Given the 12 hour downtime required to ready the autoclaves for different material, Petropavlovsk are sourcing approximately 1 months' material and dedicating a single crushing line and autoclave, before processing that specific material. This further vindicates the company's choice to use a number of smaller autoclaves.

The potential for bulk processing of third party concentrates is clearly enormous. The POX hub's proximity to the Trans-Siberian railway line (18 km to Tygda) opens up products that would not be typically economic. This is evidenced by the fact that the first batch of procured concentrate had come from Kazakhstan – several thousand kilometres away.

Blending ore materials has not proven successful, testing to date has shown that the autoclaves perform better with a homogenous feed and that is the approach that the company is taking.

The site visit presentation highlighted the extent and quality of known gold refractory deposits across Russia:

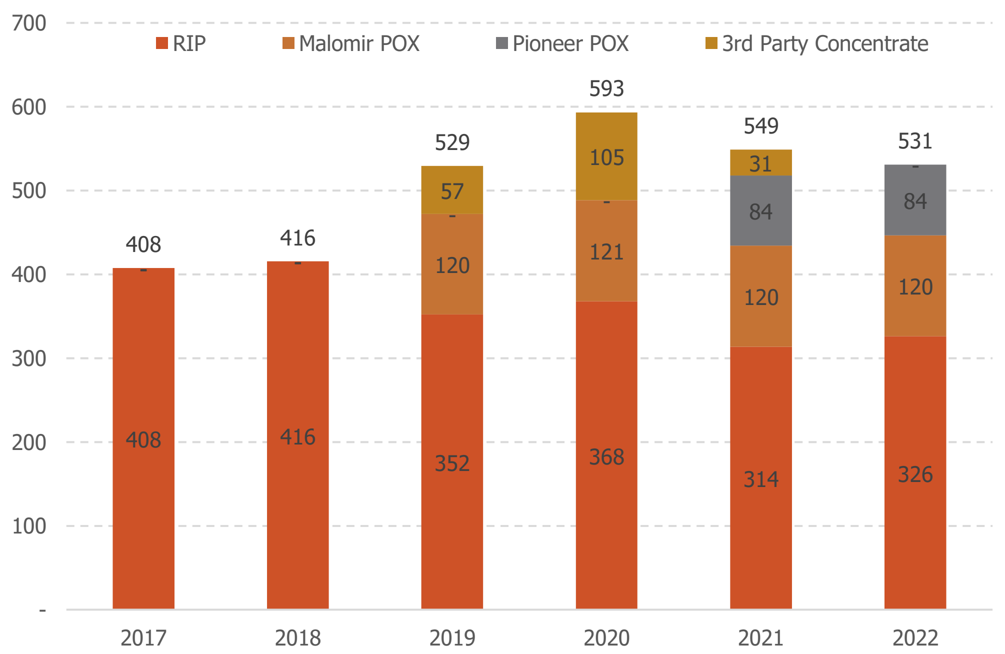
Figure 8 – Refractory Deposits Across Russia

Source: Petropavlosk

Concentrate procurement is done through the Moscow head office. There are testing facilities in St Petersburg alongside the pilot plant in Blagoveshchensk, which allows the company to test the performance of the 3rd party concentrates.

Payment is on the basis of a percentage of contained gold, with deductions for sulphur content and other deleterious elements.

Figure 9 – Gold Production by Operation



Source: Tamesis

We assume production of 472koz in 2019, and a further 57koz in third party concentrate. Whilst the economics of third party concentrate are still unknown, we are assuming free cash flow to Petropavlovsk of US$100/oz for third party concentrate.

Figure 10 – Agitation units on a frame above an operating autoclave

Source: Tamesis

Concentrate regrinding takes place on site, to a size fraction of 44µm P90 utilising existing ball mills. Lime (for neutralising the sulphuric acid generated in the oxidisation process in the autoclaves) is purchased from a local quarry and also milled on site with through two dedicated lines.

Once the concentrate has been processed through the autoclaves, the slurry is pumped back to this facility and mixed with 4% resin for adsorption, elution, and electrowinning to produce a doré.

We observed autoclaves 2 and 3 were running at full capacity, but both of the other autoclaves (1 and 4) are not dormant – they have been tested and run. The company is awaiting delivery of two additional "level meters" (x-ray measurement devices for the autoclaves) which would allow all 4 autoclaves to be running.

These are expected to be delivered and installed by September when the POX plant will be able to process up to 500ktpa of concentrate (dependent on sulphur levels and availability of concentrate).

The facility clearly has enough room for the future construction of autoclaves 5 and 6, however this would require a new or upgraded oxygen plant – adding to the potential capital burden.

The cryogenic oxygen plant comprises of two identical units, that can each only run at full capacity – effectively a fixed cost when up and running. Oxygen is estimated to be ~25% of the operating costs of the POX hub. If only two autoclaves are running only one of the oxygen plant units needs to be in operation

Figure 11 – Oxygen Plant – Exterior

Figure 12 – Oxygen Plant – Interior

Source: Tamesis

The key takeaway from the site visit to the POX hub was how compact and modern the facility is.

Procured and commissioned by Outotech, the plant is monitored and controlled electronically from a central station, has very few moving parts, and built in capacity for spares and maintenance.

Ramp up to full production appears to be going well – despite awaiting delivery of critical parts that would allow 4 autoclaves to be online simultaneously. There have been some smaller issues with gold losses in the filtration unit, to be rectified with new filters. The POX plant at Pokrovskiy does not have the issues with chlorinated water that Polymetal (LON: POLY) suffered with in the ramp up of their first POX plant in 2012/2013.

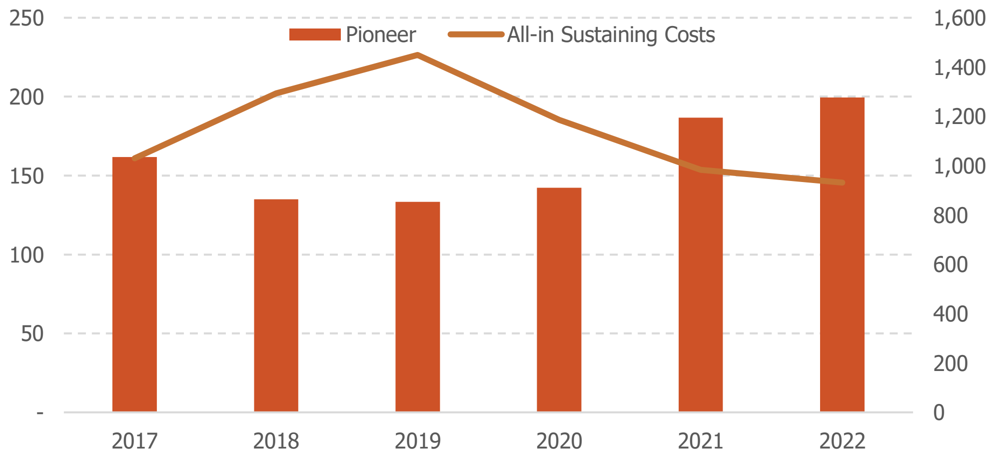
Pioneer

We only had time for a swift visit to Pioneer in an attempt to beat the incoming weather. Most interestingly, we visited the building which is designed to contain the refractory flotation plant – construction ceased in 2013.

The day after our visit the company announced the capital allocation for the construction of the float plant, expected to cost US$25-30 million. This development is critical for the ongoing profitability at Pioneer – which has increasingly had to process transition material and mine lower grade ores. Given that exploration is primarily targeting refractory ores, this is a welcome development for the company.

Outside the flotation plant and a new boiler, there are no major capital requirements at Pioneer. Included within the flotation plant capex is an additional tailings storage facility (R200m) which has no additional permitting requirements.

Figure 13 – Pioneer Production and AISC



Source: Tamesis

Refinancing

Petropavlovsk recently announced the refinancing of their US$100 million convertible notes through the placement of new US$125 million convertible bonds due 2024. The bonds have a conversion price of US$0.135/share (GBp 10.7/share at announcement date) and have a coupon of 8%.

The new US$125 million bond both gives the cash required to repurchase the convertibles and to allocate capital to the float plant at Pioneer. Notionally this maxes out the debt capacity available to the company given the covenants on the US$500 million 2022 notes, however the company has shown flexibility in managing cash requirements – one example of this would be through the existing gold prepayment facility.

Valuation

We value Petropavlovsk using a discount cashflow methodology, making adjustments for debt, working capital (including the gold forward sales) and corporate costs. Our valuation for the company is £0.16/share at a US$1,350 gold price – our target price would rise to £0.20/share at spot gold prices of US$1,406/oz.

We expect the shares to perform strongly in the near term from the positive impact of the reduced share dilution from the convertible refinance, combined with the accelerated development of the flotation plant at Pioneer.

Additionally, we think the more detailed guidance given in the analyst presentation should give the wider market more confidence in the Petropavlovsk story.

Figure 14 – Valuation Table

	US$m	**GBPm**
Albyn	528	422
Malomir	647	518
Pioneer	379	304
Third Party Concentrate	33	26
Net Debt*	(496)	(397)
IRC Stake	59	47
SG&A, Working Capital, Hedge	(502)	(401)
TOTAL NAV	**649**	**519**
NPV per Share	0.20	0.16

*Estimate as of 30/6/2019

Source: Tamesis

The company is also planning a capital markets day in September to showcase the significance of POX technology to its business going forward.

Block Model:

Petropavlovsk PLC			POG
			LSE
As at 14-Jul-19			
Share Price (GBp)	**9.65**	**Target Price (GBp)**	**16**
Model Derived:		Model Derived:	
NAV (US$m, 12%)	649	NAV (GBP/share, 10%)	519
Ordinary Shares (M)	3,302		
Convertible Shares	798		
Market Cap (US$m)	398	Market Cap (GBPm)	319
Enterprise Value (USm)	995	Enterprise Value (GBPm)	796

Price Assumptions	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Realised Price (US$/oz Au)	1304	1349	1350	1350	1350

FINANCIAL SUMMARY - USDm	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Revenue	**587**	**500**	**642**	**675**	**704**
EBITDA	197	143	205	276	305
Profit before Tax	61	82	40	129	151
Profit after Tax	**41**	**26**	**(9)**	**66**	**82**
Earnings per Share	0.01	0.01	(0.00)	0.02	0.02
Operating Cashflow per share	**0.04**	**0.07**	**0.04**	**0.02**	**0.04**
Free Cash Flow (unlevered) per Share	0.03	0.04	0.04	0.01	0.04
P/E	**9.6x**	**15.4x**	**-**	**6.0x**	**4.9x**
EV/EBITDA	**5.1x**	**7.0x**	**4.8x**	**3.6x**	**3.3x**
Price / Operating Cash Flow	3.2x	1.8x	3.4x	7.1x	3.0x
Price / unlevered FCF	4.7x	2.8x	3.3x	8.5x	2.8x

PROFIT AND LOSS STATEMENT - USDm	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Sales Revenue	587	500	642	675	704
Operating Costs	(511)	(389)	(534)	(492)	(501)
Gross Profit	**112**	**127**	**108**	**184**	**203**
Interest expense	(25)	(26)	(68)	(55)	(52)
Other expenses	(26)	(18)	-	-	-
PBT	**61**	**82**	**40**	**129**	**151**
Taxation	(19)	(56)	(49)	(63)	(69)
NPAT	**41**	**26**	**(9)**	**66**	**82**
EBITDA	**197**	**143**	**205**	**276**	**305**

VALUATION	**US$m**	**GBPm**
Albyn	528	422
Malomir	647	518
Pioneer	379	304
Third Party Concentrate	33	26
Net Debt	(496)	(397)
IRC Stake	59	47
SG&A, Working Capital, Hedge	(502)	(401)
TOTAL NAV	**649**	**519**
NPV per Share	0.20	0.16

CASH FLOW ANALYSIS - USDm	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Cash Flows From Operating Activities	**124**	**217**	**117**	**56**	**135**
Cash from Operations	204	283	234	174	256
Net Interest	(49)	(61)	(68)	(55)	(52)
Tax	(31)	(5)	(49)	(63)	(69)
Cash Flows From Investing Activities	**(88)**	**(134)**	**(65)**	**(64)**	**(46)**
Acq.of Property, Plant and Equip.	(82)	(131)	(60)	(60)	(42)
Exploration	(6)	(3)	(4)	(4)	(4)
Net Investment in Subsidiary	1	(53)	58	1	1
Cash Flows From Financing Activities	**(41)**	**(10)**	**6**	**5**	**-**
Proceeds from Equity Offering	-	-	-	-	- 0
Net Change in Borrowings	(31)	(4)	-	-	-
Transaction Costs	(11)	(6)	-	-	-
Other	-	-	6	5	-
Net Increase In Cash Held	**(2)**	**17**	**117**	**(2)**	**90**
Cash At End of Year	11	26	143	141	231

BALANCE SHEET ANALYSIS - USDm	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Current Assets					
Cash and cash equivalents	11	26	143	141	231
Trade and other receivables	76	68	71	82	86
Inventories	173	206	196	227	276
Other assets	-	27	-	-	-
Non-Current Assets					
Mining tenements & PP&E	984	1097	1023	971	886
Other assets	206	187	130	130	130
Current Liabilities					
Trade and other payables	88	220	235	135	99
Current debt	7	100	-	-	500
Other liabilities	1	12	2	2	2
Non-Current Liabilities					
Long term debt	589	594	500	500	-
Other liabilities	185	174	171	171	171
Equity	579	511	655	744	838
Net Cash/(Debt)	(666)	(788)	(592)	(494)	132

DIVISIONAL EBITDA - USDm	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Albyn	131	77	113	138	123
Malomir	22	38	109	120	122
Pioneer	75	63	23	57	101
Corporate Costs	(40)	(39)	(40)	(40)	(40)
Total	**189**	**138**	**205**	**276**	**305**

PRODUCTION (koz Au)	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Albyn	182	151	158	168	153
Malomir	66	129	181	178	178
Pioneer	160	135	133	142	187
Total	**408**	**416**	**472**	**489**	**518**
TCC (US$/oz)					
Albyn	541	744	817	705	743
Malomir	929	791	775	720	716
Pioneer	792	799	1175	947	809
Total	**741**	**784**	**902**	**781**	**757**

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