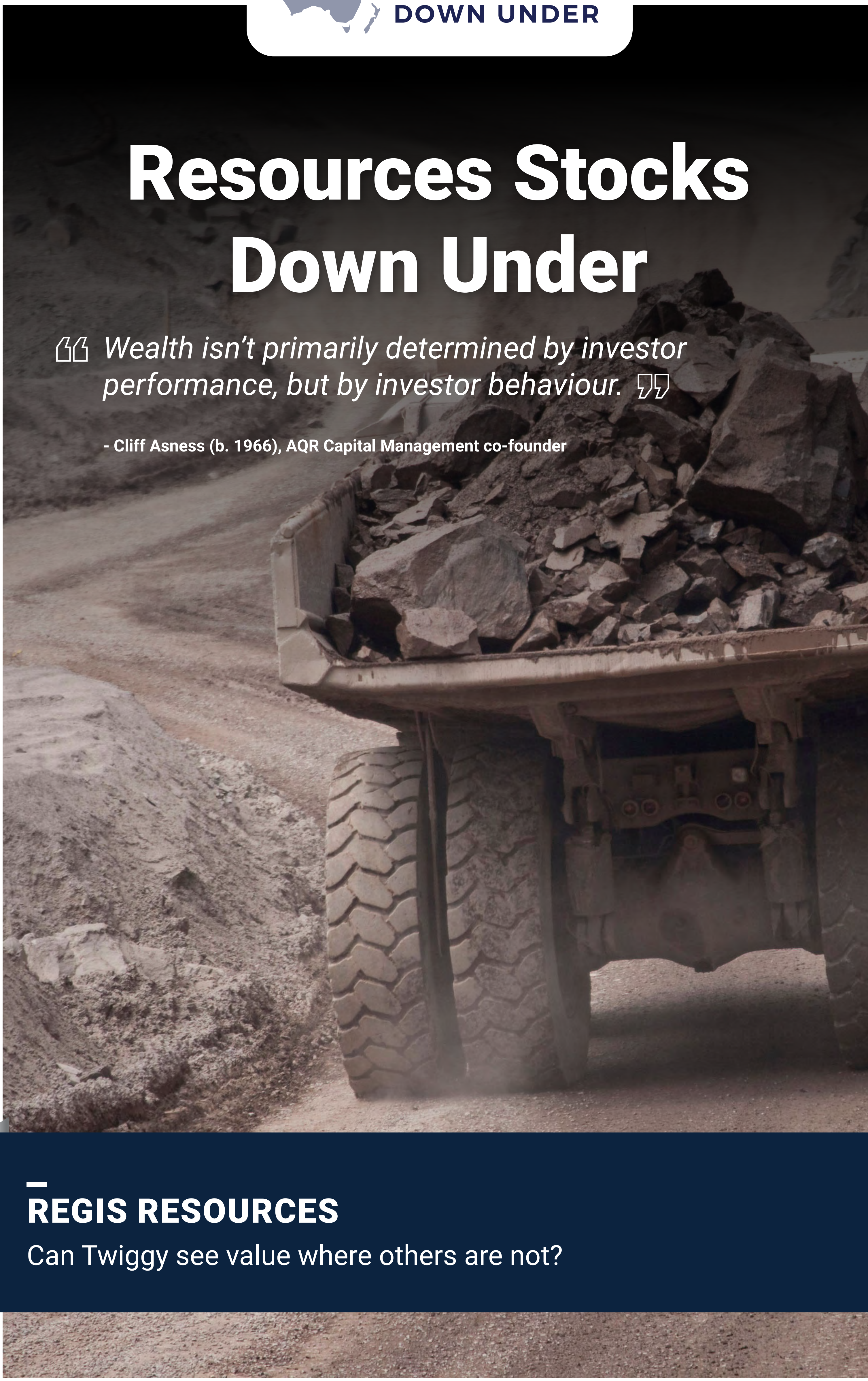
STOCKS DOWN UNDER

21 JULY 2022



Resources Stocks Down Under

> *Wealth isn't primarily determined by investor performance, but by investor behaviour.*

- Cliff Asness (b. 1966), AQR Capital Management co-founder

REGIS RESOURCES

Can Twiggy see value where others are not?

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Stocks Down Under rating: ★ ★

ASX: RRL
Market cap: A$1.2BN

52-week range: A$1.28 / A$2.70
Share price: A$1.58

Despite the success of the broader resources sector, relative to the rest of the market, gold producers haven't fared as well as their counterparts in base and battery metals. Indeed, Regis Resources (ASX: RRL) is down 20% this year and it has more than halved in five years. But shares have rebounded in July after Andrew 'Twiggy' Forrest made a bid to increase his stake in the company. His bid, while ultimately failing, begs the following question: Can he see value in Regis that other investors are not?

Share price chart

Source: Tradingview

It was one of a kind

It's been nearly two years since we last gave Regis Resources a look-in, last covering it on [5 October 2020](). At the time, the current battery metals boom was beginning, but gold was still hot, having just come off all-time record highs of over US$2,000 an ounce. Since then, a lot of heat has come out of the gold sector, as gold prices retreated to US$1,800 an ounce and investors moved to the more exciting battery metals stocks.

Regis' flagship Duketon project lies in the Eastern Goldfields of Western Australia and comprises of several mines of varying sizes. It also owns the McPhillamys Gold Project in NSW. McPhillamys is one of Australia's largest open-pittable gold projects that has yet to be developed, but it has not been approved. In mid-2021, Regis acquired IGO's 30% stake in Tropicana, buying it from IGO in April 2021 and paying $903m, funded by a capital raising. Tropicana is still operated by AngloGold Ashanti, which holds the other 70%.

Regis has mineral resources of 9.9Moz and ore reserves of 4.1Moz. It is set to report FY22 results next month and expects to record 420-475koz in annual gold production, up 13-27% on FY21. Consensus estimates forecast this will equate to $983.3m in revenue, up 20% from the year before, and $392.8m in EBITDA, down 3% from the year prior. This may not look too bad a decline, but on an EPS basis it will be 11c, less than half of the 26c EPS it made in FY21 – given the capital raising that enabled the Tropicana purchase.

Looking to FY23, consensus estimates expect $1.1bn in revenue and $481.4m in EBITDA, up 14% and 22% from the year before. Regis is trading at 2.7x EV/EBITDA and 7.8x P/E for FY23, has $180m cash and bullion on hand, and an EBITDA margin of 40%.

Twiggy's attempted bid

Unfortunately, Regis' share price has underperformed, even with Andrew Forrest's attempted raid on the company's registry back on June 30. The Fortescue boss actually was a shareholder already, with a 4.9% stake, but shareholders only have to disclose ownership as part of a standalone ASX announcement when they exceed 5%. Forrest wanted a further 15% which would have given him a stake of 20% and likely signaled that he wanted to take over the company. His broker, Barrenjoeys, could not complete a deal for the entire stake and so the deal was off, even though he was willing to pay a 13.8% premium to the previous day's closing price ($1.48). Ironically, the share price has now reached the level he was willing to buy those shares at. Will he try again? We think it is unlikely at least until Regis' FY22 results are announced and FY23 guidance is given.

But why was Regis' share price low to begin with? We think the catalyst was a disappointing mineral resource update just three weeks prior. Its group ore reserves dropped from 4.8Moz to 4.1Moz. And investors also feared Regis was being hit by worker absenteeism and labour availability, simply because this had been a problem with many of its WA peers since Omicron arrived. Yet, these are short-term issues in the broader context of the company. We think there are more fundamental reasons why Regis' share price has been slowing down.

Has Tropicana ruined everything?

As we noted above, Regis' EBITDA for FY22 will be lower and we think it is because of the squeeze in its margins due to lower gold prices and higher All-In Sustaining Costs (AISC). In FY20 it had an AISC of $1,246 but it has forecast A$1,425-A$1,500/oz for FY22. Ironically, Tropicana is lower cost, at A$1,140-A$1,230 while Duketon is at A$1,540-A$1,610. It's all well and good to have record production, but it still isn't appealing when gold prices are lower.

Notwithstanding Tropicana's lower costs, we still think this project isn't panning out the way investors expected. Its broader Group mineral resources had actually dropped since it took over the project from 301Mt at 1.1g/t for 10.4Moz of gold to 287Mt at 1.1g/t gold for 9.9Moz gold. Analysts covering Regis have argued that it paid too much for Tropicana, assuming gold prices would stay at 2020-21 levels for the long term. Laypeople could also argue that IGO just wouldn't be selling if it saw future value in it. We also remind our readers that even if Tropicana was delivering, Regis has a stake of just 30% in it so it will not derive as much benefit as AngloGold Ashanti.

An additional fear is that we expect the company will continue to be hit by general industry inflationary pressures. The company has said this would be an issue, but we will only be able to quantify the impact when it releases its FY22 results next month. Even before that, Regis will be outlining FY23 production and cost guidance in less than a week and of course its FY22 results next month - we will be watching both events closely. But, given inflationary pressures in the industry, combined with the juxtaposition of lower gold prices and higher costs for Regis, we think it deserves two stars right now.

Pitt Street Research Pty Ltd

3 Spring Street, Sydney, NSW 2000, Australia

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