

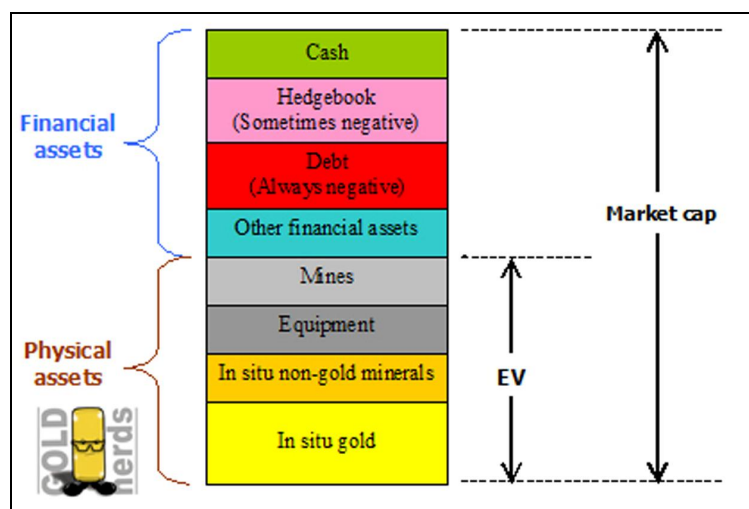
INVESTMENT TOOLS FOR COMPARING GOLD STOCKS (PART 2)

As published in the September 2011 issue of Australian Resource and Investment Magazine. For anyone wanting access to a great mining publication (online version is free) I encourage you to register at: www.australianresourcesandinvestment.com.au

In the last issue we investigated the usefulness of applying the Total Cost per oz (TCO) indicator to compare the relative value of gold mining companies. Today, I want to introduce two other important pieces of the investment puzzle. We will analyze the **Net Financial Asset position (NFA %)** of a company coupled with the importance of a sound **Share Structure**. These two factors are very much interrelated. The stronger a company's operational performance, the stronger its balance sheet tends to be (as measured by NFA). This generally means less shareholder dilution as the company is less dependent on capital raisings to survive (fewer shares outstanding). After briefly explaining the theory behind these concepts, we will finish off with a practical demonstration.

As investors in gold mining companies we have one common goal. **We want to invest in companies which demonstrate an ability to grow shareholder wealth (not just their market capitalization) and thus maximize our return on investment. That is, companies with a proven track record of developing and running profitable operations whilst issuing share capital sparingly.** Now this might sound fairly obvious to most, but there are very few producing gold mining companies which successfully achieve this goal. The fact that there are so few makes identifying the success stories much easier. The key is to know what to look for. The easiest way to do this is to study the characteristics of some of the best and worst performing companies. We will be doing this shortly in our practical example but before then a little theory.

The Net Financial Asset position (NFA %): At first glance this probably sounds like complicated financial speak. Not so. Last issue we touched on the concept of an Enterprise Value for a company. This was the Market Capitalization less the company's net financial assets (or liabilities). This resulted in the value the market was placing on the company's non-financial assets (projects, equipment etc) or in other words the Enterprise Value. Graphically this looks as follows:

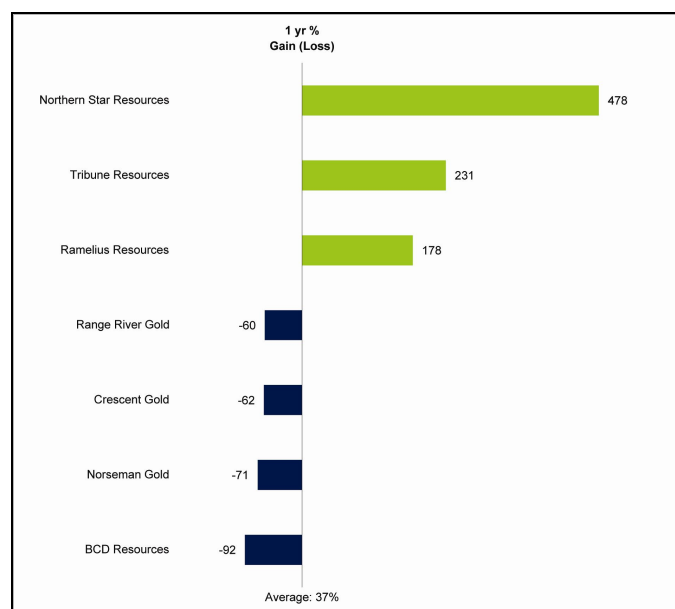


Our Net Financial Assets (NFA) position indicator is simply the company's net financial position divided by the market capitalization. This specifically looks at what proportion of the company's market capitalization is made up of net financial assets (positive %) or net financial liabilities (negative %). Our practical example will demonstrate how the best performing companies tend to have a stronger NFA (%). In contrast, companies with below average performance are usually burdened with debt and excessive financial obligations (a significantly negative NFA %).

Share Structure: This is simply the number of shares a company has issued. Who would think this basic piece of information holds any clues? Many company executives dismiss the importance of this number as they audaciously go to the market time and time again for capital. For many gold producing companies this becomes their life line. The banks will no longer lend to them due to poor operational performance and desperate shareholders are all that's left. Many shareholders feel obligated because, if they don't collectively participate, they risk the company going into administration and the loss of their entire original investment (the bulk of which has already been lost). Sadly, very often it's a case of throwing good money after bad.

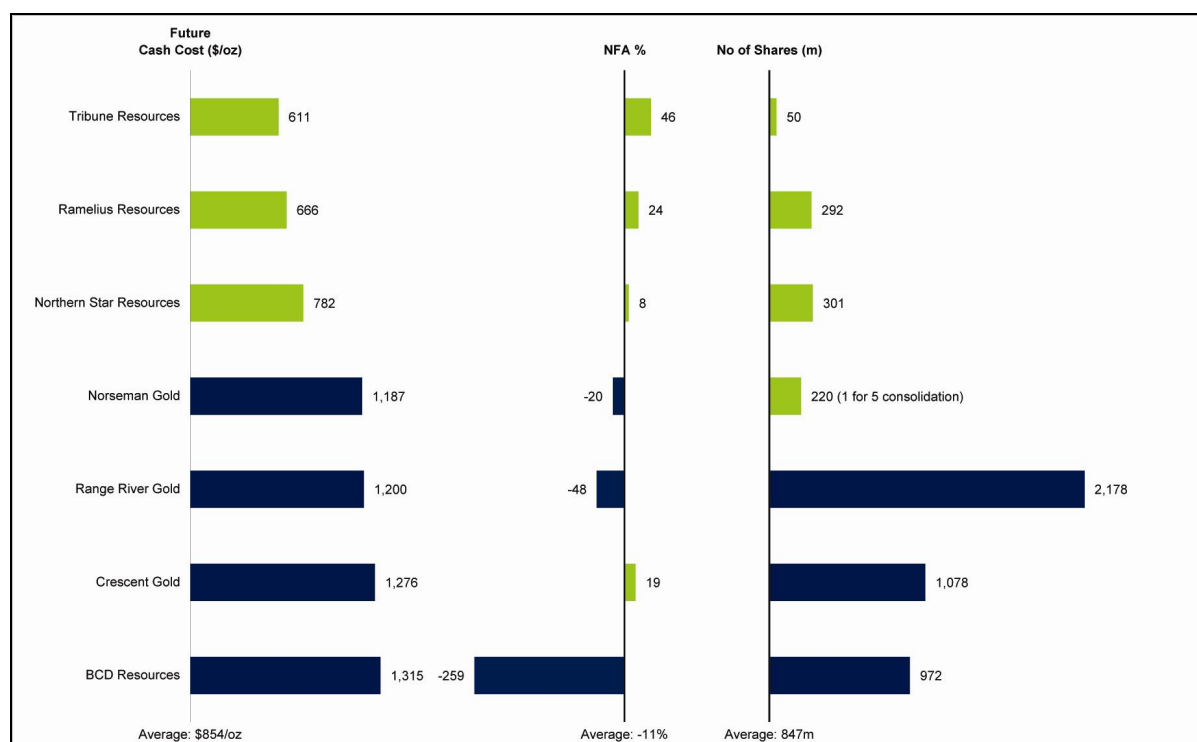
The fewer shares a gold mining company has outstanding the better. It demonstrates self sufficiency which is more conducive to growing shareholder wealth. Some companies muddy the waters by consolidating their share capital. They do this by undertaking what's called a Reverse Split. They might offer 1 share for every 10 outstanding, thus reducing a 1 billion share structure to a more attractive looking 100 million share structure. The share price will increase 10 fold creating the illusion of growth. I liken this to taking a car with 1 million kilometers on the odometer and resetting the mileage to zero. The car is no closer to being new again than these companies are to reversing the damage done via previously poor share capital management. At GoldNerds, we specifically track share capital information in our reports and identify the scenarios where Reverse Splits have occurred.

Producers (Market Cap < \$0.5b & Production > 20koz pa)



Source: Extract from Gold Stock Summary Report (Mar Qtr 2011 Issue)

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Our first chart above contrasts the three best performing small capitalization (less than \$500 million) gold producers with the 4 worst in terms of share price performance over a 12 month period to the 20th of June 2011. The green bars represent above average and the blue bars below average (the average is for the 24 companies in total which make up this category). The next chart includes these same companies along with our before mentioned indicators. I am sure it won't take many of you long to discover a trend. The best performing companies enjoy a better than average future cash cost and not by coincidence a strong NFA (%). When you glance over to the number of shares outstanding the numbers are also significantly better than average. I repeat, when a company is profitable this lessens the reliance on capital raisings facilitating stronger share price appreciation.

In contrast, when we study the indicators for the poorly performing companies we observe the polar opposite. We see future cash costs well above the average and consequently, mostly negative NFA percentages. If this is not the case (Crescent Mining), we only have to look at the number of shares outstanding to typically see why. Range River is presently in administration and the ability of these other companies to survive will be largely dependent on improved operational performances, future capital raisings or merger and acquisition.

To be fair, mining is a difficult business with many challenges. At GoldNerds, we compile our database for the sole purpose of improving investor awareness. Our information not only helps investors discover

safer undervalued opportunities but also, importantly, provides a tool to monitor existing investments. These companies are rarely a buy and hold proposition. Even the best mines have a finite life and any strongly performing company can very easily find itself an underperformer before too long. Likewise, we have seen underperforming companies successfully turn their fortunes around. The key for investors is having the information to be able to meaningfully track this progress.

If you are interested in investing in the gold mining sector and think our indicators and reports may be useful and you would like to find out more, I encourage you to visit www.goldnerds.com.au

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