

# SF tips Smaller Companies **Gold** Fund

## Newsletter - Issue 29, September 2011

### QE3 Is The Name, Printing Money Is The Game - By Ross Jones & Tom Winnifrith



On the three year anniversary of the collapse of Lehman the first global liquidity bailout has been jointly announced by the central banks of the West. The European Central Bank has decided, in conjunction with the Federal Reserve, the Bank of England, the Bank of Japan and the Swiss National Bank, to conduct three Dollar liquidity providing operations with a maturity of circa three months. The provisions will all take the form of repurchase operations against eligible collateral and will be carried out as fixed rate tender procedures with full allotment. What this means is that to solve the evident liquidity crisis the central banks are stepping up to provide shiny new Dollars in exchange for 'eligible' collateral, i.e. first rate debt issued by countries such as Greece. This is great news in the short term if you are a bank, and equities jumped on the news as it takes some immediate pressure off European banks's funding concerns, but in the long run it just postpones the final reckoning. Peter Boockvar, managing director and equity strategist at Miller Tabak & Co summed it up quite well; "The house is burning and we're dousing it with some water [but] that doesn't necessarily mean the fire is fully out."

Prior to the announcement a handful of (again poor) US data points had emerged. Initial claims for jobless benefits in the latest week rose to 428,000, compared with expectations of a reading of 415,000, and the Empire State Manufacturing Index for September, a reading on New York-area manufacturing activity, worsened to -8.82, compared with expectations of a -4 reading. But in the short term the markets are not bothered now that the Euro liquidity crisis is temporarily 'solved'. But for anyone that has missed the true meaning of the ECB's announcement - this is QE on a World wide scale!

But what actually is Quantitative Easing, and what will its impact be?

The above are key questions every investor should ask. QE is an instrument used by central banks, in this instance the Federal Reserve, Bank of England et al, that is hoped will kick start increased economic growth. The Fed buys Treasury Bonds (and other financial assets), the ECB buys Greek debt, and the Bank of England buys any other rubbish asset no one else wants, as a means of increasing the supply of money to large financial institutions. The ultimate outcome is that it is hoped this will encourage banks to increase lending. This in turn will theoretically assist everyday people refinance their debts and mortgages, spur bargain hunters back into the housing market, encourage companies (through low interest loans) to increase investment spending and subsequently create jobs, etc, etc. However, a quick look at the impact of the last \$600 billion package (QE2) in the US shows that none of the above were achieved. In general US house prices have continued to fall since last Summer, economic growth has slowed, and unemployment is still stubbornly high (with real unemployment even higher).

But one impact QE2 did have was to push up inflation, and subsequently make the cost of living for everyday people a whole lot more expensive than even a year ago. But it did help stock markets rally – note the swing in volume and buying in London following the news, and big banks generate some hefty earnings on their investment banking arms (which are far more exciting than loans to everyday home owners, plus the central bank is always there to bail them out if the trades go seriously wrong) and earn some great fees through IPOs such as LinkedIn. Plus in addition, banks like Goldman were also able to front run the Fed's asset purchases last time and with inflation being the friend of anyone who has debt, remember that the US is the most heavily indebted nation in the World, QE could be deemed a great success.

So all QE2 did was make the rich even richer and the middle classes and poor even worse off than a year ago every time we visit the supermarket or spend our devalued money on any of the things that the Government measures of inflation do not account for. But despite this, in some form a further dose of QE is obviously due to attempt to cure the sick economy. But as we have said on numerous occasions past performance is not a good indicator of future prospects but what it can show to some extent is that if something has not worked in the past it is unlikely to work if you do the exact same again. The Fed and other central banks are struggling with this concept.

Disaster myopia has once again set in. Economists typically base their rules around rough heuristics and given that QE has no past track record to even draw upon, Bernanke's 'rules of thumb' make up the QE handbook. This worryingly parallels the Greenspan utopian economics handbook which took the US economy from one bubble to the next and then to a pretty major crash – that is to say that there was only an eight month down dip following the tech and the real estate bubbles.

With the EU in as much a mess as the US, plus the uncertainty surrounding the allegedly misleading loans sold to Fannie and Freddie, and the East only warranting circa 15 – 20% of any portfolio there really is little other choice but to move hard earned wealth into Gold or, what we reckon will deliver better returns in the long run, Gold mining equities. Equities are, in our view a much better investment than bullion alone given the fact that they are directly geared to increases in the Gold price. Despite Gold trading at record highs the companies that are taking the stuff out of the ground have not been rerated accordingly. Fundamentally this does not make sense and given the fact that even before this equities had lagged the Gold price, they are now seriously undervalued. Simply put an increased Gold price means increased cash flows for producers and increased valuations of resources for explorers and near term producers. This is however not currently reflected in market valuations.

Forecasting when this inevitable rerating will take place is futile but in the time being we have continued to do what we have been doing throughout the previous month of market weakness; that is to say we have piled into equities where at \$1,500 Gold we saw serious upside. The maths are even more compelling now. A few companies of note are **Cluff Gold**, **Shanta**, **Vatukoula**, and **Norseman**, the latter is especially attractive given that it is a relatively high cost producer.

## **Ross Jones & Tom Winnifrith**

You can download the application form from [here](#) and the simplified prospectus from [here](#). If you have any

questions please contact 01624 641 318 or email [goldfund@t1psim.com](mailto:goldfund@t1psim.com).

## Fund Information

<b>Size:</b>	£22,538,482.41 (16/09/11)
<b>Launch date:</b>	24 July 2009
<b>Launch price:</b>	£1.00
<b>Current Yield:</b>	0.00%
<b>Legal Status:</b>	OEIC
<b>Annual Management Fee:</b>	1.5%
<b>Initial Charge:</b>	5.25%
<b>Minimum lump sum Investment:</b>	£500.00
<b>Minimum monthly investment:</b>	£25.00
<b>SEDOL code:</b>	B3YQ855
<b>Unit offer price:</b>	Single Priced Fund Last Dealt Price: 179.23p (16/09/11)
<b>Unit bid price:</b>	As Above

## Top 10 Holdings

<b>Stock Name</b>	<b>Fund %</b>
Ascot Mining	7.11
Ariana Resources	6.38
Vatukoula Gold Mines	6.27
Hambledon Mining Plc	6.23
First Majestic Silver	3.75
Cluff Gold	3.67
Great Panther Silver	3.31
Norseman Gold	3.26
Romios Gold	3.06
Angel Mining	3.04

## Benchmarking

Total return, bid to bid line chart from 11/09/2009 to 16/09/2011 from UKUT and OEICs Universe



### Cumulative Performance - 15/08/2011

	1m	3m	6m	1y	3y	5y
SF t1ps Smaller Companies Gold Fund	-1.4	-1.6	-12.7	+40.6	n/a	n/a
IMA Specialist	+0.4	-7.6	-6.6	-2.3	+20.3	+18.8

### Discrete Performance - 15/08/2011

	1y	3y	5y	12m-24m	24m-36m	36m-48m	48m-60m
SF t1ps Smaller Companies Gold Fund	+40.6	n/a	n/a	+27.4	n/a	n/a	n/a
IMA Specialist	+1.0	+23.0	+21.6	+15.9	+5.1	-10.6	+10.6

The Fund was launched in September 2009 and 3-year and 5-year performance results are not available.

Source: Financial Express

Past performance is not a reliable indication of future results

## How To Buy Gold Fund Units

1. You can deal through [www.JPJShare.com](http://www.JPJShare.com) at the initial fee rate of 2%.
2. **Contact your broker.** Most brokers offer the chance to buy units although few can match JPJShare.com's initial rate of 2%. But call your broker and give him the fund's SEDOL code: **B3 YQ 855**. If your broker will

not deal please call Sarah Read on 01624 641318 and she will try to rectify the situation.

3. Deal directly through t1ps and The Share Centre at the initial fee rate of 2.5%. If you want an application form email [goldfund@t1psim.com](mailto:goldfund@t1psim.com) or go to [www.t1psim.com](http://www.t1psim.com).

4. If you choose to invest directly, once you have made an initial investment (of as little as £500) you can set up a monthly standing order with The Share Centre to drip feed further cash (as little as £25 a month) into the fund. All existing fund holders can set up such an order.

If you have any questions about investing in the SF t1ps Smaller Companies Gold Fund visit our website at [www.t1psim.com](http://www.t1psim.com) or email [goldfund@t1psim.com](mailto:goldfund@t1psim.com)

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## On The News Front - By James Faulkner



Despite a slightly weaker than expected production profile and a tough operating environment in Angovia, **Cluff Gold**, the West African focused miner, delivered a set of solid first half numbers on 12th September 2011. A 20-25% appreciation in the Gold price helped offset weaker year on year production and saw Cluff post a headline 158% increase in EBITDA, which came in at \$11.1 million. A net \$9 million was generated from operations in the period, which was almost wholly driven by the strong performance at the company's cash cow, Kalsaka.

At 31,500 ounces, production at Kalsaka, was broadly in line with the previous half. Half on half this falls short of the targeted 35,000 ounces which will see the company reach its 70,000 ounce guidance. But with production following the period end improving, 16,000 ounces was produced in July and August alone, our view is that the company will not have an issue reaching its targeted full year output. Moving over to the second of the group's operating facilities in the Ivory Coast, leaching operations have now recommenced following the political turbulence, which saw the operation shut down, and gold recovery is expected to ramp up to full production by the first quarter of 2012. The second half of the year should simply be better given the fact that there will be not half as much pressure on costs seeing as the Ivory Coast operation is now moving forward.

A total of \$12.5 million was burnt in the period with the net \$9 million generated from operations used entirely to fund capital expenditure on both exploration and tangible assets. This saw the group end the first half of the year with \$17.7 million of cash. Of this \$12.5 million, \$9 million alone was spent on exploration and feasibility work at Baomahun with some of the results of this expenditure being released to the market on 5th September 2011 when the company announced a 46% increase in its Indicated Resource and a jump in total resources from 2.4 million to 3 million ounces.

In the long term Baomahun is the key for the company and it expects to release its definitive feasibility study in Q4 2011. However, the main difference now is that the study will be working with a de-risked open pit only scenario, which in our view is positive in both the short and medium to long term. The current guidance is

that Baomahun will produce 150,000 ounces a year with early estimates of cash costs coming in at \$500 an ounce. More guidance should be provided by Q4 but with 3 million ounces in the ground, along just 4 kilometres of a potential 12 kilometre structure, at \$1,500 Gold Baomahun should be throwing off an annualised £94.5 million. Add this to the £28.6 million at Kalsaka and the current market cap of £147.7 million is a good way to being covered.

There is however the issue here that the project is going to cost c£123 million (this is without the expenditure needed for a potential hydro power facility which will see cash costs fall but may require a higher capital investment initially) so investors are evidently aware that in the short term dilution could be a real issue. The management have however noted that all shareholders will be offered the opportunity to partake in any fundraise and that in addition a good deal of the funding will potentially be raised by what we read as some sort of debt facility.

Our view is that given Cluff's potential despite the risk off attitude there will be appetite when funds are to be raised given that moving forward Cluff should continue to benefit from positive momentum building seeing as it has delivered a pretty decent resource upgrade (with upside still a potential due to the 8km left along the potential 12 kilometre structure) and some strong H1 numbers. H2 should however be better and with the company having already enjoyed two months of the strongest Gold prices on record, Kalsaka should be throwing off some serious cash. With the end of the wet season drawing near, exploration drilling across the company's other assets should help keep investors occupied until Q4 when the company will announce the plans for its defining operation. It is hoped that Baomahun will see the company reach its target of 250,000 ounces a year by 2013 and as noted above at \$1,500 gold the company will, at this point, be generating cash of £123.1 million. This sees the shares trade on just 1.2 times projected cash flow. But this is simply the base case. For every \$50 increase in the Gold price add another £7 million to the cash pile a year.

There is however the issue here that Baomahun is still at least a year from production and as with every mining operation the best made plans do not always come through and delays are always a potential. But with a decent cash pile, and the fact that currently the company already has a cash cow funding its operations, investment here is far less speculative compared to a non producer – that is to say that Cluff is selling Gold now and enjoying the record prices which will push through to significantly increased cash flows. In the short term we are looking forward to Q4 2011 and have recently bought more shares in the market. The upside here materially outweighs the potential worry over the period between now and Baomahun output and the dilution associated with the Baomahun project.

Another one of our holdings that announced results on 12th September 2011 was South African focused **Pan African Resources**. The highlights were that gross revenue from Gold sales increased by 15.62% to £79.2 million and that EBITDA came in 14% higher at £28.5 million. However, despite just falling short of its targeted 100,000 ounce output, as a result of poor rock wall conditions demanding attention and a short term labour strike, the company grew its earnings per share by almost 16% to 1.2p. This allowed the Directors to increase the full year dividend by 38% to 0.5135p, costing a total of £7.4 million – a good sign of confidence moving into the next full year. In addition, the Resource inventory was expanded by 22.46% to 5.67 million ounces, with reserves at Barberton increasing by just over 50% to 1 million ounces. This has extended the mine life to seventeen years, an increase of seven years. As at 30th June 2011 the company remained debt free and had cash of £10.1 million after a 256% increase in capital expenditure of £21 million.

In addition to the main operations at Barberton, moving into this year Pan African plans to increase production toward 120,000 ounces by adding a tailings re-treatment facility to its operations. The expected capital cost to bring this to life will be circa £22.5 million and will, from November 2012 onwards, add up to 24,000 ounces to the company's targeted 100,000 annual output. There is also the further upside here from additional dumps which could potentially lengthen the life of this operation. The company also provided guidance that by the end of 2011, its Phoenix plant, which is 6 weeks ahead of schedule, should be producing c12,000 ounces of PGMs once full production is reached. This adds a further layer of diversity to the company's revenue mix.

With just over £10 million in the kitty, a further £13.7 million available via its revolving credit facility, and strong Gold sale prices currently generating record cash flows, there are no short term capital worries here. This year, with a new labour agreement firmly in place, Barberton should produce 100,000 ounces of Gold. Assuming an average sale price of \$1600 and that costs remain broadly in line with the year just gone, Barberton alone should be generating close to £50 million free cash flow. This will allow the company to comfortably self fund the £22.5 million of capital expenditure needed to complete the Bramber tailings project and the Phoenix operation.

Of further near term interest is the company's intention to spin off its Manica project located in Mozambique. The company believes that a separate listing here will allow it to focus its resources on near term organic growth opportunities at the South African operations whilst enabling it to retain an equity interest in a newly listed entity. In June the project pre feasibility study was released, which was based on a resource of 33.8 million tonnes grading 2.36 grams per tonne gold. The initial study provided guidance for a two phased mine design, the first phase being an open-pit mine and the second being an extension into an underground operation. The study indicated that Manica has the potential to house a mine with an eleven year life, and should produce Gold at an annualised rate of 80,000 ounces at a cash cost of just under \$400/oz. All in the project is set to cost \$80 million.

The justification for the spin off seems clear. Manica is at least eighteen months away from preliminary production and in the short term the funds from the separate listing, could be used to acquire a much nearer term producing deposit to add to the company's South African operation, which is a potential scenario currently unaccounted for. Furthermore, the company is currently benefiting from record sale prices and with such an attractive back drop for Gold it would not be surprising, once Bramber comes online, if the company moves into the re-treatment of other mining operations's tailings, similar to fellow portfolio member, Goldplat.

Currently trading at 12.625p, capitalising the company at £181 million, taking into account the NPV of the company's South African operations, the cash position, the potential funds from Manica, and not to mention potential exploration upside (which we currently attribute no value to), despite the wider worries regarding the country it operates within, Pan African's valuation is less than demanding. Uniquely the shares also offer a surprisingly chunky (for a gold miner) yield of 4.1%. This goes a good way to limit the downside risk, given that the peer group average (for those that even pay a dividend) is just under 1%. With an internal target price of 16p we are content to **hold**.

**James Faulkner**

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## Risk warning:

**The value of your investment can go down as well as up and you may not get back a significant proportion of your investment. Past performance is not a reliable indicator of future results. If you are in any doubt as to the suitability of an investment, you should seek independent financial advice. \* Please remember that the tax treatment depends on the individual circumstances of each investor and may be subject to change in the future.**

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