Pan African Resources

Canning coal

Disposal and financing

Metals & mining

Since our last update note, Pan African Resources (PAF) has announced the disposal of its 91% interest in its coal asset, Uitkomst, for ZAR275m (£16.3m, or US$20.9m), a placing to raise ZAR705m (£41m, or US$51m) and an update on progress at its Evander underground refurbishment. As well as returning an exceptional profit to the company, the disposal self-evidently returns Pan African to its core competency of gold mining. It also materially reduces risk in the form of its net funding requirement while developing Elikulu.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
06/15	140.4	16.0	0.64	0.54	25.4	3.3
06/16	168.4	45.9	2.08	0.88	7.8	5.4
06/17e	203.4	26.0	1.19	0.58	13.7	3.6
06/18e	204.8	57.7	2.16	1.12	7.5	6.9

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles and exceptional items.

Uitkomst sale

PAF announced the disposal of Uitkomst on 5 April for ZAR275m, representing capital appreciation of ZAR127m over its purchase price of ZAR148m (excluding working capital) in March/April 2016. Moreover, this appreciation was amplified by forex movements, from c ZAR21.0535/£ in March/April 2016, to ZAR16.8680/£ currently, which translates to an acquisition price of £7.0m and a disposal price of £16.3m in sterling terms. In addition, PAF received a ZAR30m dividend from Uitkomst during the period of its ownership. The sale is subject to the usual conditions precedent. The transaction value represents a multiple of 1.4x Uitkomst's net asset value and 7.1x annualised current year profits after taxation (on a 100% basis). Consideration for PAF's 91% interest is to be settled in cash (ZAR125m plus ZAR25m deferred) and unrestricted Coal of Africa shares (261.3m valued at ZAR125m, including an 8% discount to CoAL's 30 day VWAP).

Elikhulu fully funded

As a consequence of the Uitkomst sale and its April share sale, we estimate that PAF's maximum group net funding requirement over the period of Elikhulu's development will now be a mere £20.4m in FY19 (cf £71.6m previously), which is self-evidently well covered by both PAF's existing ZAR800m revolving credit facility and a new ZAR1.0bn facility with Rand Merchant Bank.

Valuation: 20.22p/share, rising to 25.23p in FY22

Updating our long-term forecasts to reflect Uitkomst's disposal and the April share placing, our absolute value of PAF decreases by a mere 5.4%, from 21.38p/share to 20.22p/share. The decrease is almost exclusively attributable to the 19.3% increase in the effective number of shares in issue, but also, in part, as a result of the relative strength in the value of the rand against both sterling and the US dollar after a period of hubris in March and April. In the meantime, PAF's shares are noticeably cheap, within the historical context, when considered relative to our forecasts of normalised HEPS in FY18 compared to prior years (see page 4).

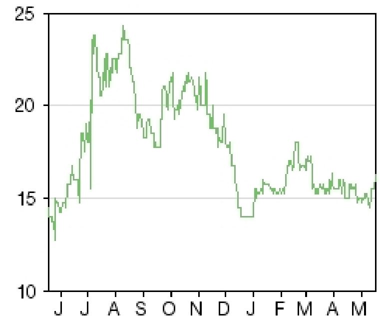
17 May 2017

Price	**16.25p**
Market cap	**£363m**

ZAR16.8680/£, ZAR13.1710/US$, US$1.2809/£

Net debt (£m) at end December 2016	33.2
Shares in issue (effective 1,798.3m post consolidation)	2,234.7m
Free float	77%
Code	PAF
Primary exchange	AIM/JSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	8.3	(8.5)	6.6
Rel (local)	5.7	(11.9)	(12.5)
52-week high/low		24.2p	12.8p

Business description

Pan African has six major precious metals' assets in South Africa: Barberton (target output 95koz Au pa), the Barberton Tailings Retreatment Project (20koz), Evander (95koz), the Evander Tailings Retreatment Project (10koz), Elikhulu (53koz) and Phoenix Platinum (12koz).

Next event

FY17 results	September 2017

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Edison profile page

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Disposal & Elikhulu financing

The timing of the Uitkomst sale is with respect to an ‘effective date’, which has yet to be determined. For simplicity however, we have assumed that the ‘effective date’ falls on, or soon after 1 July 2018 (being the first day of PAF’s next financial year, FY18). As a result, our forecasts for FY17 (which include a full contribution from Uitkomst) remain largely unchanged relative to our last note (excepting an adjustment to costs at Evander – see below). Our forecasts for FY18 now include an assumed £3.9m profit on the disposal of Uitkomst (included in ‘Loss in associate etc’ in Exhibit 1, below):

Exhibit 1: Pan African underlying P&L statement by half-year (H114-H218e) actual and expected

£000s (unless otherwise indicated)	H114	H214	H115	H215	H116	H216	H117	H217e	FY17e	FY18e
Mineral sales	84,637	69,914	68,126	72,951	75,632	93,728	105,046	101,256	206,303	205,021
Realisation costs	(191)	(159)	(295)	(396)	(269)	(687)	(1,548)	(1,346)	(2,894)	(235)
Realisation costs (%)	0.23	0.23	0.43	0.54	0.36	0.73	1.47	1.47	1.40	0.12
On-mine revenue	84,447	69,755	67,831	72,555	75,363	93,041	103,498	99,911	203,409	204,785
Gold cost of production	(52,519)		(52,727)		(48,935)	(51,102)	(65,188)	(71,856)		
Pt cost of production	(1,590)		(1,797)		(1,651)	(1,796)	(2,300)	(2,529)		
Coal cost of production							(10,568)	(5,972)		
Cost of production	(54,109)	(52,285)	(54,524)	(55,889)	(50,586)	(57,637)	(78,056)	(80,357)	(158,414)	(133,356)
Depreciation	(5,088)	(4,935)	(4,676)	(5,661)	(5,277)	(5,180)	(6,450)	(8,032)	(14,482)	(10,770)
Mining profit	25,249	12,535	8,631	11,005	19,500	30,225	18,992	11,521	30,513	60,660
Other income/(expenses)	(223)	(1,227)	523	(273)	(3,486)	(8,697)	2,175	(2,302)	(127)	(1,082)
Loss in associate etc	(89)	(84)	(128)	0	0	0	256	0	256	3,913
(Loss)/profit on group disposal			(140)		0	0	0	0	0	0
Impairment costs	0	(12)	(56)	(2)	0	0	0	0	0	0
Royalty costs	(1,747)	(272)	(795)	(852)	(1,194)	(1,606)	(968)	(1,508)	(2,477)	(3,138)
Net income before finance items	23,191	10,940	8,034	9,878	14,819	19,923	20,455	7,711	28,166	60,353
Finances income	381	306	321	28	144	299	70			
Finance costs	(725)	(153)	(498)	(1,960)	(558)	(891)	(1,079)			
Net finance income	(344)	153	(177)	(1,932)	(414)	(592)	(1,009)	(1,025)	(2,034)	176
Profit before taxation	22,847	11,093	7,857	7,946	14,405	19,331	19,446	6,686	26,131	60,529
Taxation	(5,537)	(1,618)	(2,310)	(1,823)	(3,480)	(4,754)	(5,475)	(1,868)	(7,343)	(18,758)
Marginal tax rate (%)	24	15	29	23	24	26	28	28	28	31
Deferred tax										
Profit after taxation	17,310	9,475	5,548	6,122	10,925	14,577	13,970	4,818	18,788	41,771
EPS (p)	0.95	0.52	0.30	0.33	0.60	0.82	0.93	0.30	1.20	2.32
HEPS** (p)	0.95	0.52	0.31	0.33	0.60	0.82	0.91	0.30	1.20	2.32
Diluted EPS (p)	0.95	0.52	0.30	0.33	0.60	0.80	0.93	0.30	1.17	2.27
Diluted HEPS* (p)	0.95	0.52	0.31	0.33	0.60	0.80	0.91	0.30	1.17	2.27

Source: Pan African Resources, Edison Investment Research. Note: As reported basis; *Profit re Uitkomst sale; **HEPS = headline earnings per share (company adjusted basis).

Note that our group-wide forecasts for PAF are for production of 183.8koz of gold in FY17 compared to management’s guidance of 181koz.

Share placing

On 12 April, Pan African announced its proposed funding package for its Elikhulu tailings project, comprising:

- A placing to existing and new institutional investors of 291.5m new ordinary shares at an issue price of 14p per placing share to raise £41m, or ZAR705m or US$51m.
- A ZAR1.0bn (US$76m or £59m at prevailing forex rates) underwritten seven-year debt facility, which has been agreed in principle with Rand Merchant Bank (a division of FirstRand Bank Limited). The debt facility has credit approval, but remains subject to finalisation of definitive legal agreements and the fulfilment of conditions precedent, including licensing approvals and

other conditions typical and/or customary for such a facility. Capital is to be repaid through equal quarterly repayments after a grace period of two years. Note that, as part of the credit approval process, RMB appointed Mineral Corporation as its independent technical advisor with a remit to review the Elikhulu DFS for fatal flaws, which it did, but did not identify any such flaws.

Following the placing, Pan African has 2,234.7m shares in issue. However, this includes 436.4m shares that are held by PAR Gold Proprietary Limited (formerly known as Shanduka Gold) and which are treated as treasury shares on consolidation. For accounting and reporting purposes therefore, following the placing, Pan African now has 1,798.3m effective shares in issue (cf 1,506.8m previously).

The decline in Edison's FY17 EPS forecast from 1.36p per share previously to 1.20p/share currently (on an "as reported" basis – see Exhibit 1) arises, in part, as a result of this increase in the average number of shares in issue during the period and, in part, in anticipation of higher costs than previously expected at Evander to reflect the time period over which the retrenchment process (communicated to shareholders on 10 March) has been implemented. Note that our FY17 EPS forecast of 1.20p per share compares with a mean consensus estimate of 1.94p, within the range 1.40-2.66p, excluding Edison (source: Bloomberg, 15 May 2017).

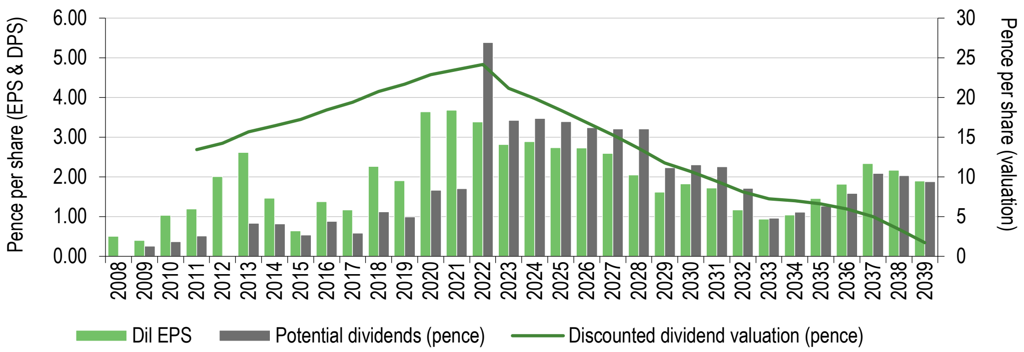
Similarly, the mining aspects of our FY18 forecasts remain unchanged, with our current forecast varying from our previous forecast only as a result of changes in the average number of shares in issue, the net interest charge and the inclusion of the profit as a result of the Uitkomst colliery disposal. Within this context, note that our forecast EPS of 2.32p/share assumes a gold price for the year of US$1,248/oz and compares with a mean consensus of 2.42p within the range 2.00-2.92p.

Valuation

Updating our long-term forecasts to reflect these changes, our absolute value of PAF decreases by just 5.4%, from 21.38p/share to 20.22p/share. This is almost exclusively attributable to the 19.3% increase in the effective number of shares in issue, but also, in part, as a result of the continuing strength in the value of the rand against both sterling and the US dollar, having largely recovered from the hubris created by the removal from office of the Finance Minister, Pravin Gordhan, by the President, Jacob Zuma, in March.

Our valuation is based on the present value of our estimate of the maximum potential stream of dividends payable to shareholders over the life of PAF's mining operations (applying a 10% discount rate).

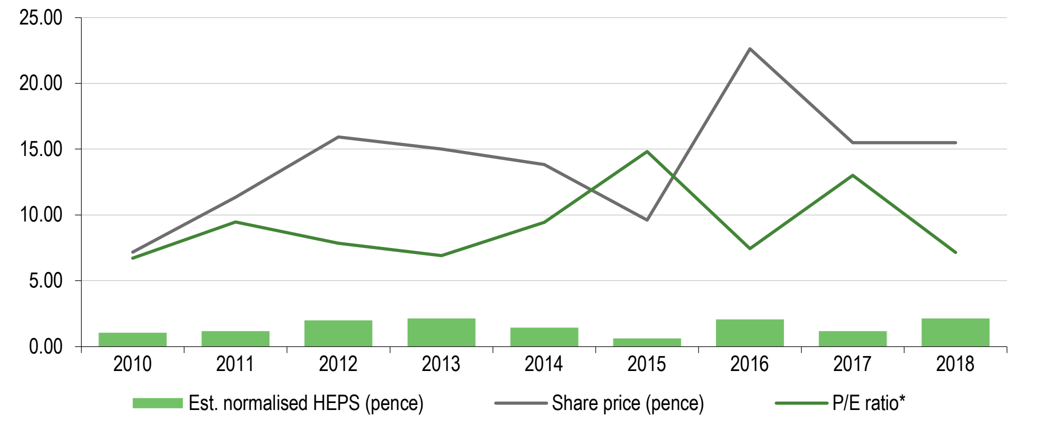
Exhibit 2: PAF estimated life of operations diluted EPS and (maximum potential) DPS



Source: Edison Investment Research, Pan African Resources

In addition however, at their current price, Pan African's shares are noticeably cheap, within the historical context, when considered relative to our forecasts of normalised HEPS in FY18 compared to prior years:

Exhibit 3: Pan African historical current year price:normalised HEPS ratio



Source: Edison Investment Research, Bloomberg. Note: *Calculated with respect to average share price within the year shown and normalised HEPS; zero normalisation assumed prior to 2016.

Financials

Pan African had £33.2m in net debt on its balance sheet as at 31 December 2016 after the payment of a £17.1m final dividend in late December (cf £22.8m as at 30 June 2016, £16.2m as at 31 December 2015 and £18.0m as at 30 June 2015). As at that date therefore, net debt equated to a gearing (net debt/equity) ratio of 16.7% and a leverage (net debt/[net debt + equity]) ratio of 14.3%. However, that net debt position should now have reversed into a net cash position after the April share placing plus six additional months of cash-inflows from operations.

Our forecasts for Pan African's immediate capital expenditure commitments related to Elikhulu by financial year are as follows:

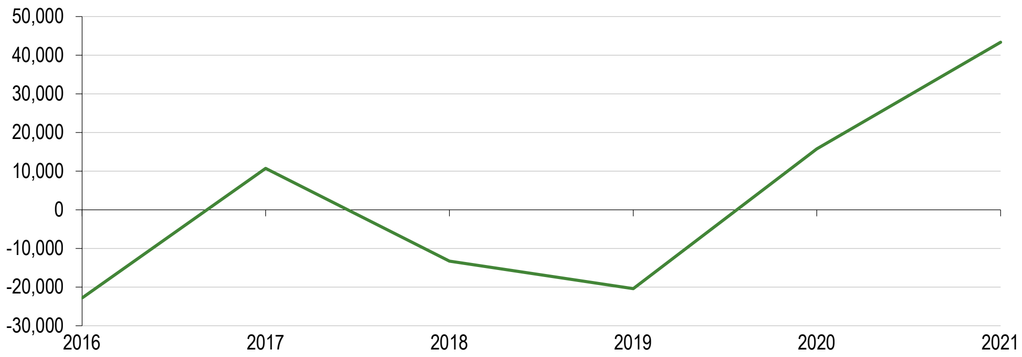
Exhibit 4: Estimated Elikhulu capex requirements by financial year

£000s	FY17	FY18	FY19	FY20	FY21	FY22
Total capex*	20,492	54,236	33,935	8,626	18,391	18,391

Source: Pan African Resources, Edison Investment Research. Note: *Includes sustaining capex, but excludes phase 3 capex, which commences in FY26.

Elikhulu's permitting process is reported to be progressing well. In the meantime, maintaining a dividend policy of 40% of free cash flows less sustaining capital, debt repayments and exceptional items, Pan African's funding requirement, on our estimates, will evolve during the period in which Elikhulu is being developed from FY16 to FY21, as follows:

Exhibit 5: Pan African estimated funding requirement, FY16 to FY21e



Source: Edison Investment Research, Pan African Resources

Whereas we had previously been expecting PAF to be net debt free by the end of FY21, following the £41m share placing in April, we now expect this to be brought forward to FY20.

Note that PAF's maximum group net funding requirement of £20.4m in FY19 (cf £71.6m in FY19 previously), based on our estimates, equates to ZAR344m at prevailing forex rates, or gearing (debt/equity) of 8.6% and leverage (debt/[debt+equity]) of 7.9% - and is self-evidently well covered by either PAF's existing ZAR800m revolving credit facility (which can anyway be expanded to ZAR1,100m) or its new ZAR1.0bn underwritten seven-year debt facility with Rand Merchant Bank.

Note that the group's revolving credit facility (RCF) debt covenants and their actual recorded levels within recent history are as follows:

Exhibit 6: Pan African group debt covenants

Measurement	Covenant	31 December 2016 (actual)	30 June 2016 (actual)	31 December 2015 (actual)
Net debt:equity	Must be less than 100%	17%	35%	50%
Net debt:EBITDA	Must be less than 2.5x	0.48x	0.12x	0.13x
Interest cover ratio	Must be greater than four times	21.99x	23.98x	18.08x

Source: Pan African Resources

Exhibit 7: Financial summary

£'000s	2011	2012	2013	2014	2015	2016	2017e	2018e
Year end 30 June	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Revenue	79,051	100,905	133,308	154,202	140,386	168,404	203,409	204,785
Cost of sales	(45,345)	(46,123)	(71,181)	(106,394)	(110,413)	(108,223)	(158,414)	(133,356)
Gross profit	33,705	54,783	62,127	47,808	29,973	60,181	44,995	71,430
EBITDA	28,540	45,018	53,276	44,165	28,448	57,381	42,519	68,292
Operating profit (before GW and except.)	25,655	41,759	47,278	34,142	18,110	46,925	28,037	57,522
Intangible amortisation	0	0	0	0	0	0	0	0
Exceptionals	0	(48)	7,232	(12)	(198)	(12,183)	129	2,831
Other	0	0	0	0	0	0	0	0
Operating profit	25,655	41,711	54,510	34,130	17,912	34,742	28,166	60,353
Net interest	762	516	197	(191)	(2,109)	(1,006)	(2,034)	160
Profit before tax (norm)	26,417	42,274	47,475	33,951	16,001	45,919	26,002	57,683
Profit before tax (FRS 3)	26,417	42,226	54,707	33,939	15,803	33,736	26,131	60,513
Tax	(9,248)	(12,985)	(12,133)	(7,155)	(4,133)	(8,234)	(7,343)	(18,758)
Profit after tax (norm)	17,169	29,290	35,342	26,796	11,868	37,685	18,659	38,924
Profit after tax (FRS 3)	17,169	29,242	42,574	26,785	11,670	25,502	18,788	41,755
Average number of shares outstanding (m)	1,432.7	1,445.2	1,619.8	1,827.2	1,830.4	1,811.4	1,567.6	1,798.3
EPS - normalised (p)	1.20	2.03	2.18	1.46	0.64	2.08	1.19	2.16
EPS - FRS 3 (p)	1.20	2.02	2.63	1.47	0.64	1.41	1.20	2.32
Dividend per share (p)	0.51	0.00	0.83	0.82	0.54	0.88	0.58	1.12
Gross margin (%)	42.6	54.3	46.6	31.0	21.4	35.7	22.1	34.9
EBITDA margin (%)	36.1	44.6	40.0	28.6	20.3	34.1	20.9	33.3
Operating margin (before GW and except.) (%)	32.5	41.4	35.5	22.1	12.9	27.9	13.8	28.1
BALANCE SHEET								
Fixed assets	97,281	86,075	249,316	223,425	220,150	230,676	249,580	292,317
Intangible assets	38,229	23,664	38,628	37,040	37,713	38,682	40,418	42,154
Tangible assets	59,052	62,412	209,490	185,376	181,533	190,725	207,893	248,894
Investments	0	0	1,199	1,010	905	1,269	1,269	1,269
Current assets	15,835	41,614	26,962	23,510	17,218	22,016	57,199	33,103
Stocks	1,457	1,869	6,596	5,341	3,503	4,399	6,877	6,834
Debtors	4,254	6,828	15,384	12,551	10,386	14,891	14,130	14,043
Cash	10,124	19,782	4,769	5,618	3,329	2,659	36,125	12,160
Current liabilities	(8,960)	(11,062)	(24,066)	(24,012)	(22,350)	(32,211)	(38,384)	(34,095)
Creditors	(8,960)	(11,062)	(23,202)	(19,257)	(17,301)	(25,230)	(31,403)	(27,114)
Short-term borrowings	0	0	(864)	(4,755)	(5,049)	(6,981)	(6,981)	(6,981)
Long-term liabilities	(13,410)	(14,001)	(80,004)	(63,528)	(67,850)	(69,506)	(70,876)	(72,232)
Long-term borrowings	(181)	(869)	(11,133)	(8,141)	(16,313)	(18,456)	(18,456)	(18,456)
Other long-term liabilities	(13,228)	(13,132)	(68,871)	(55,387)	(51,537)	(51,049)	(52,420)	(53,775)
Net assets	90,746	102,626	172,208	159,396	147,167	150,975	197,519	219,094
CASH FLOW								
Operating cash flow	31,968	49,092	61,618	45,996	26,423	47,130	47,104	63,052
Net Interest	762	516	314	(606)	(2,109)	(1,006)	(2,034)	160
Tax	(10,743)	(11,616)	(13,666)	(8,536)	(3,943)	(7,777)	(5,972)	(17,403)
Capex	(21,712)	(17,814)	(27,197)	(21,355)	(19,554)	(14,097)	(33,386)	(65,898)
Acquisitions/disposals	0	(1,549)	(96,006)	0	(760)	(30,999)	0	16,303
Financing	1,545	259	47,112	349	(235)	15,207	38,236	(0)
Dividends	(5,376)	(7,416)	0	(14,684)	(15,006)	(9,882)	(10,481)	(20,181)
Net cash flow	(3,557)	11,471	(27,826)	1,164	(15,184)	(1,425)	33,466	(23,965)
Opening net debt/(cash)	(12,756)	(9,943)	(18,913)	7,228	7,278	18,033	22,778	(10,688)
Exchange rate movements	925	(1,813)	594	(839)	(276)	812	0	0
Other	(181)	(688)	1,090	(375)	4,705	(4,131)	0	0
Closing net debt/(cash)	(9,943)	(18,913)	7,228	7,278	18,033	22,778	(10,688)	13,277

Source: Company sources, Edison Investment Research

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