

Gemfields Group

H1 results

A new strategic shareholder

We believe the phased purchase of a 26.17% stake in Gemfields by mining holding company Assore International Holdings should be regarded as a vote of confidence in Gemfields' value proposition. Despite recent share price appreciation, the current price remains more than 30% below our DCF sum-of-the-parts valuation of ZAR4.69/share. Strong results, including US\$23.1m at the July/August commercial quality emerald auction, reflect a strong coloured gemstone market. H1 results saw EBITDA of US\$43.5m from revenues of US\$97.2m.

Year end	Revenue (US\$m)	PBT* (US\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/19	216.2	55.9	1.3	0.0	15.8	N/A
12/20	34.6	(84.7)	(6.1)	0.0	N/A	N/A
12/21e	196.4	32.5	0.4	0.0	51.3	N/A
12/22e	239.8	49.7	1.2	0.0	17.1	N/A

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

Assore now a 26.17% shareholder of Gemfields

A recent interesting development in Gemfields' story is the purchase of 26.17% of Gemfields shares in three tranches by South Africa-based mining holding company Assore. While Assore's long-term intentions in relation to this strategic stake are as yet unclear, we see this as a vote of confidence in Gemfields' value proposition.

Putting COVID behind it with solid H121 results

Despite the continuing inability to hold full in-person auctions, Gemfields used its alternative auction format to achieve H121 revenue of US\$97.2m, well above both the severely COVID-affected H120 (US\$15.0m) and also pre-COVID H119 revenue of US\$89.0m. H121 EBITDA was US\$43.5m (H120 EBITDA loss of US\$24.7m), giving an EBITDA margin of 45%, albeit this is somewhat flattered by the quirks of inventory accounting as most of H121 sales were from inventory. Gemfields ended H121 with net cash of US\$28.7m from net debt of US\$12.6m at year end. Operations at both Kagem and Montepuez Ruby Mining (MRM) restarted in March 2021 after a year of COVID-related suspensions and ramped up to full capacity in May. Gemfields will hold its next high-quality emerald and mixed-quality ruby auctions in November/December.

Valuation: US\$367m updated sum-of-the-parts DCF

Our updated sum-of-the-parts DCF valuation of US\$367m (previously US\$345m) equates to a value per share of 24p or ZAR4.69. The share price remains well below the DCF valuation despite strong appreciation in recent months.

Metals & mining

30 September 2021

Price **ZAR3.07**
Market cap **ZAR3,590**

ZAR14.95/US\$

Net cash (US\$m) at 27 August 2021 20.3

Shares in issue 1,168.8m

Free float 69.2%

Code GML

Primary exchange Johannesburg

Secondary exchange AIM

Share price performance



Business description

Gemfields Group is a world-leading supplier of responsibly sourced coloured gemstones. It owns 75% of Montepuez Ruby Mining in Mozambique, 75% of Kagem Mining in Zambia, the Fabergé jewellery business and an investment in Sedibelo Platinum.

Next events

Auction results December 2021

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H1 results very strong despite COVID-19 challenges

Although COVID-19 continues to present a number of challenges for Gemfields in terms of the ability to hold in-person ruby and emerald auctions, this is not apparent in the H121 results, which saw the company generate US\$97.2m in revenue, US\$43.5m in EBITDA (45% EBITDA margin) and US\$38.0m in PBT. All these figures are well above the comparable period in 2020, where sales were significantly affected by COVID, as well as pre-COVID H119 levels.

With operations remaining suspended through most of the first quarter, H1 results benefited from lower cash costs (only partially offset by inventory adjustments). The group values its rough emerald and ruby inventories based on their weighted average cost of production. Direct costs of production are capitalised to the balance sheet when incurred, with the average cost accumulated per carat then released to the income statement when the gemstones are sold. Because sales in H121 were skewed towards high-value but low-carat volumes, this resulted in a relatively small (US\$7.9m) inventory adjustment in H121 where this figure would have been significantly higher had a greater volume of lower-quality (but high-volume) stones also been sold. This has somewhat flattered EBITDA margins in H1 and investors should not expect a similar result in H2 when cash costs will be higher, driven by the resumption of production at both Kagem and MRM, the return to full salaries for the executive team and increased marketing expenditure.

H1 profit before tax also benefitted from a US\$7.7m fair value gain on the company's investment in Sedibelo following the significant recent improvement in PGM prices.

Exhibit 1: H121 key metrics

	H119	H120	H121
Revenue (US\$m)	89.0	15.0	97.2
EBITDA (US\$m)	33.1	(24.7)	43.5
PBT (US\$m)	21.2	(66.1)	38.0
EPS (c)	0.8	(4.4)	1.6

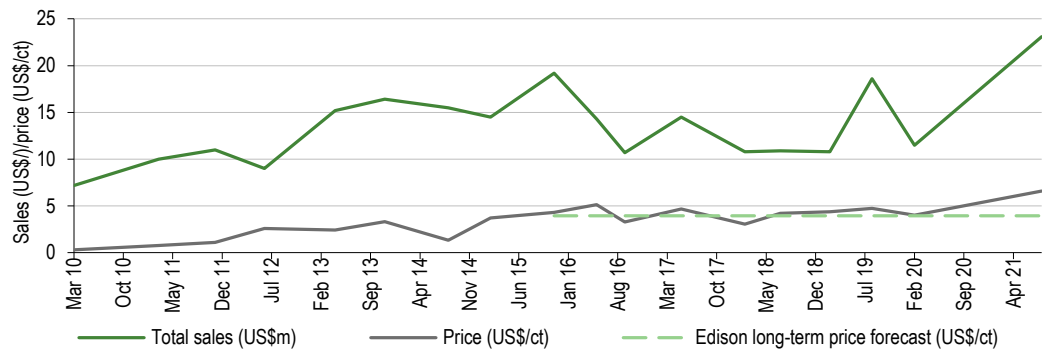
Source: Gemfields Group

Gemfields ended H121 with net cash of US\$28.7m from net debt of US\$12.6m at year end. H1 cash flow from operating activities of US\$50.6m includes a US\$11.6m movement in working capital. The company spent US\$3.3m in capex during the period.

Alternative auction format has been a resounding success

Ordinarily, Gemfields generates more than 90% of its revenues from four to six emerald and ruby auctions held in person in Singapore and Lusaka, with customers attending from all over the world. Since February 2020, travel restrictions have prevented the company from holding full in-person auctions in this way. Gemfields has developed an alternative process whereby emeralds and rubies are shown in multiple locations before being auctioned online. Despite the logistical and market challenges of selling in this revised way, Gemfields achieved H121 revenue of US\$97.2m, not only way above H120, when just one auction was held giving group revenue of US\$15.0m, but also 9% above H119's group revenue of US\$89.0m

Both the high-quality emerald and mixed-quality ruby auctions held during H121 achieved very good results (as discussed in our previous note [Maxi-mini auction results](#)) and, more recently, the July/August commercial-quality emerald auction was a resounding success. Not only did it achieve total revenue of US\$23.1m (compared to our forecast of US\$14.4m), a new record for a Kagem commercial-quality auction, but pricing of US\$6.60/ct was also at a new all-time high. As shown in Exhibit 2 below, the pricing achieved in this auction suggests that the value of Kagem's commercial-quality stones may be surpassing its previous steady range (and our long-term forecast). However, pricing at individual auctions can vary according to the particular mix of stones sold, so we would advise against reading too much into the results of a single auction.

Exhibit 2: Kagem commercial-quality auction results


Source: Gemfields Group

The next auctions to be held will be a mixed-quality ruby auction in November/December 2021 and a high-quality emerald auction around the same time. These will once again follow the modified format of multi-jurisdiction showings followed by an online auction process. From next year, Gemfields would like to return to single-location, in-person auctions but most likely keeping the online bidding system. The company believes that having all of the buyers in a single location will result in the best bids and also offers costs savings for Gemfields.

Rapid ramp-up of MRM and Kagem since operations resumed

Gemfields suspended mining at Kagem in March 2020 and at MRM in April 2020 in response to COVID-related risks. Ongoing COVID risks and the need to preserve cash while gemstone auctions could not take place meant that operations did not resume until March 2021. Despite the lengthy shutdowns, resumption and ramp-up of operations to full capacity has progressed smoothly and rapidly, with both operations at full capacity by the end of May 2021. The speed of the ramp-up means Gemfields should not struggle to produce sufficient high-quality rubies and emeralds to supply full (online) auctions in November/December this year, and so the constraint on H2 sales is likely to be the strength of market demand rather than production.

Strategic investor Assore buys 26.17% of Gemfields

On 3 September, Assore International Holdings acquired 58.4m shares, being 5.0% of Gemfields. On 17 September that position was increased to 148.9m shares (12.74%) and on 29 September to 305.81m (26.17%). Assore is a South African mining holding company which owns 50% of Assmang, 100% of Dwarsrivier Chrome Mine and 25% of IronRidge Resources. Assore was listed on the Johannesburg Stock Exchange for 70 years before delisting in May 2020. It is owned by members of the Sacco family and various Black Economic Empowerment (BEE) entities.

During Gemfields' half year results conference call, the company was asked whether it had any insight into Assore's longer-term intentions. Their response was that it was not able to comment on Assore's intentions, but it was Gemfields' understanding that Assore 'intends to be a supportive long-term holder'. Without any further clarity on the intentions of the new strategic investor, it is difficult to take a view on what this new development may mean for Gemfields' shareholders. Nevertheless, we see the purchase of a strategic stake by an experienced mining investor as a clear vote of confidence in Gemfields' value proposition.

Over the past two years, Gemfields has had extensive [correspondence](#) with a group of activist investors who have questioned certain aspects of its corporate governance and strategy. The company has sought to address the group's key concerns, but with only partial success. As such, Gemfields remains potentially vulnerable to activist intervention.

Financials

Following a rapid ramp-up of operations at both Kagem and MRM, we now expect 2021 production to be higher than previously forecast. However, as previously, we believe that sales will be constrained primarily by market demand rather than production. Our 2021 revenue forecast for MRM is unchanged at US\$108m (implying H2 auction revenue of US\$49m). Following the very successful July/August commercial-quality emerald auction, which brought in US\$23.1m in revenue at an average price of US\$6.61/ct, we have increased our 2021 revenue forecast for Kagem to US\$79m (from US\$72m), implying H2 revenue of US\$47m (including US\$23.1m from the commercial-quality auction). Our 2021 group revenue forecast moves to US\$196.4m (from US\$190.1m previously). Our 2022 revenue forecast is virtually unchanged at US\$239.8m (from US\$240.3m previously).

Taking into account the H1 results, we now forecast 2021 cash mining and production costs of US\$76m (previously US\$77m) and SG&A of US\$52m (previously US\$56m). Given the lower starting point of current SG&A we now forecast 2022 SG&A of US\$60m (from US\$64m previously), with the increase compared to 2021 driven by increased selling and marketing costs as sales increase.

Our 2021 EBITDA forecast is US\$56.2m, from US\$33.1m previously. In addition to higher Kagem revenue and lower cash costs, our 2021 forecast benefits from lower than expected costs associated with the sale of rubies and emeralds from inventory during H1. We had expected a higher proportion of previously capitalised costs to be expensed when stones were sold from inventory but, because of the particular mix of stones sold, the inventory adjustment was significantly lower than we had forecast, and we now forecast a full year inventory adjustment of US\$12m from US\$24m previously). We forecast 2022 EBITDA of US\$78.6m (from US\$80.8m previously), with lower SG&A than previously forecast offset by a higher 2022 inventory adjustment.

Exhibit 3: Forecast key metrics

	Previous	New
Kagem HQ emerald production 2021 (kct)	742	769
Kagem HQ emerald production 2022 (kct)	972	972
Kagem revenue 2021 (US\$m)	72	79
Kagem revenue 2022 (US\$m)	90	90
MRM premium ruby production 2021 (kct)	68	72
MRM premium ruby production 2022 (kct)	149	149
MRM revenue 2021 (US\$m)	108	108
MRM revenue 2022 (US\$m)	135	135
Faberge revenue 2021 (US\$m)	10	10
Faberge revenue 2022 (US\$m)	15	15
Group revenue 2021 (US\$m)	190	196
Cash mining and production costs 2021 (US\$m)	(77)	(76)
Selling general and admin (US\$m)	(56)	(52)
Change in inventory 2021 (US\$m)	(24)	(12)
Group EBITDA 2021 (US\$m)	33	56
PBT 2021 (US\$m) (reported basis)	(0.3)	30.5
EPS 2021 (c)	(1.5)	0.4
Closing net cash/(debt) 2021 (US\$m)	(6.6)	8.6
Group revenue 2022 (US\$m)	240	240
Group EBITDA 2022 (US\$m)	81	79
PBT 2022 (US\$m) (reported basis)	50	48
EPS 2022 (c)	1.5	1.2
Closing net cash/(debt) 2022 (US\$m)	7.9	15.9

Source: Edison Investment Research

In addition to sustaining capital expenditure, Gemfields will spend US\$35m over the next two years on the planned doubling in capacity of the MRM wash plant. We forecast group capex of US\$20m in 2021 (previously US\$25m) and US\$39m in 2022 (previously US\$34m). Cash from operations will

more than fund this capital requirement and we now expect Gemfields to end 2021 with net cash of US\$8.6m (previously net debt of US\$6.6m) and to end 2022 with net cash of US\$15.9m (previously US\$7.9m).

Sensitivities

In addition to the normal operational, safety, environmental and other risks of any mining operation as well as COVID-related operational risks, Gemfields currently has two key risks to which we think investors should pay particular attention – heightened political and security risks in Mozambique and market risk in the coloured gemstone market.

Heightened political and security risk in Mozambique

Since 2017, there has been a rise in insurgent attacks in the Cabo Delgado region in northern Mozambique, where Gemfields' MRM mine is located. The insurgents are linked to Islamist militant groups with connections to Islamic State but are also tapping into local political grievances. Those attacks escalated through 2020 and it is estimated that some 850,000 civilians have been displaced by the violence. In recent months, in coordination with Rwandan and Southern African Development Community (SADC) troops, Mozambique's armed forces have continued to gain control over areas previously occupied by insurgents, but the situation remains fluid. Although the Montepuez district is some distance from the fighting and Gemfields' operations have not been directly affected, the security situation in this region is a key risk for Gemfields.

Coloured gemstone market risk

Although the success of the March/April and July/August mini-auctions indicated a strong market for coloured gemstones, the strength of those results in part reflects pent-up demand as no ruby auctions were held by MRM in 2020, and Kagem sold just US\$11.4m in commercial-quality emeralds in February 2020 and US\$10.9m in high-quality emeralds in late 2020. Whether coloured gemstone market demand will remain as strong as supply ramps back up remains a key risk for the company.

Valuation

As previously, we value Gemfields on a discounted cash flow sum-of-the-parts basis (at a 10% discount rate).

- Our updated sum-of-the-parts valuation totals US\$367m or 24p per share (previously US\$345m or 22p per share).
- The rand per-share valuation (of interest mostly to South African investors) is affected by the impact of the weaker rand (ZAR14.95/US\$ versus ZAR14.28/US\$ previously) on the translation of our US dollar-driven valuation of Gemfields to rand per share.

Key changes to our valuation from our last note comprise higher 2021 revenue at Kagem and lower SG&A at both operations, as well as at corporate level. Those changes see our Kagem DCF valuation increase by US\$9m to US\$180m, our MRM DCF valuation increase by US\$8m to US\$303m and corporate overheads reduce by US\$10m to a DCF of -US\$159m.

Exhibit 4: Sum-of-the-parts valuation

	New valuation	Previous valuation
Kagem (75%) US\$m	180	171
Montepuez (75%) US\$m	303	295
Fabergé (100%) US\$m	17	21
Sedibelo (6.54%) US\$m	40	40
Corporate overheads US\$m	(159)	(169)
Net cash US\$m (31 December 2020)	(13)	(13)
Sum of the parts valuation US\$m	367	345
Rand per share	4.69	4.21
Pence per share	24	22

Source: Edison Investment Research

Exhibit 5: Gemfields financial summary

	\$m	2018	2019	2020	2021e	2022e
31-December		IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT						
Revenue		206.1	216.2	34.6	196.4	239.8
Cost of Sales		(123.5)	(118.5)	(58.0)	(115.2)	(128.2)
Gross Profit		82.5	97.8	(23.4)	81.1	111.6
EBITDA		58.9	80.9	(30.0)	56.2	78.6
Operating Profit (before amort. and except.)		28.2	46.1	(51.1)	29.3	52.0
Fair value gains (losses)		(41.9)	14.3	(27.9)	7.9	0.0
Exceptionals		(22.6)	13.2	(13.5)	0.0	0.0
Share-based payments		(4.2)	(1.7)	(0.9)	(2.0)	(2.0)
Reported operating profit		(40.4)	71.9	(93.4)	35.2	50.0
Net Interest		(8.8)	(4.5)	(5.8)	(4.7)	(2.3)
Joint ventures & associates (post tax)		0.0	0.0	0.0	0.0	0.0
Profit Before Tax (norm)		(22.5)	55.9	(84.7)	32.5	49.7
Profit Before Tax (reported)		(53.9)	67.4	(99.2)	30.5	47.7
Reported tax		(6.5)	(28.2)	6.0	(21.7)	(26.0)
Profit After Tax (norm)		(29.0)	27.6	(78.8)	10.9	23.6
Profit After Tax (reported)		(60.4)	39.1	(93.2)	8.9	21.6
Minority interests		(1.8)	(10.8)	7.9	(6.5)	(9.6)
Net income (normalised)		(30.8)	16.9	(70.8)	4.3	14.0
Net income (reported)		(62.2)	28.4	(85.3)	2.3	12.0
Average Number of Shares Outstanding (m)		1,170	1,265	1,169	1,170	1,170
EPS - basic normalised (c)		(2.6)	1.3	(6.1)	0.4	1.2
EPS - normalised (c)		(2.6)	1.3	(6.1)	0.4	1.2
EPS - basic reported (c)		(5.3)	2.2	(7.3)	0.2	1.0
Dividend per share (c)		0.0	0.0	0.0	0.0	0.0
Revenue growth (%)		152.4	4.9	(-84.0)	468.1	22.1
Gross Margin (%)		40.1	45.2	-67.8	41.3	46.6
EBITDA Margin (%)		28.6	37.4	-86.9	28.6	32.8
Normalised Operating Margin		13.7	21.3	-147.7	14.9	21.7
BALANCE SHEET						
Fixed Assets		509.7	507.4	457.9	446.7	456.8
Intangible Assets		52.3	55.2	51.5	51.5	51.5
Tangible Assets		365.0	376.9	362.7	355.9	367.9
Investments & other		92.4	75.3	43.7	39.4	37.4
Current Assets		224.4	276.8	198.8	230.1	220.6
Stocks		99.2	110.7	117.8	106.4	96.2
Debtors		62.1	87.8	37.1	58.0	62.4
Cash & cash equivalents		63.0	78.2	43.9	65.6	61.9
Other		0.0	0.0	0.0	0.0	0.0
Current Liabilities		(60.6)	(75.2)	(59.5)	(84.4)	(76.4)
Creditors		(28.2)	(29.9)	(18.2)	(25.0)	(27.0)
Tax payable		(1.4)	(16.3)	(4.3)	(17.3)	(10.4)
Short term borrowings		(23.2)	(24.8)	(33.0)	(38.0)	(35.0)
Other		(7.9)	(4.2)	(4.0)	(4.0)	(4.0)
Long Term Liabilities		(123.4)	(130.1)	(114.2)	(109.7)	(101.7)
Long term borrowings		(30.0)	(28.0)	(23.5)	(19.0)	(11.0)
Other long-term liabilities		(93.4)	(102.1)	(90.7)	(90.7)	(90.7)
Net Assets		550.1	578.9	483.0	482.8	499.2
Minority interests		(73.9)	(84.7)	(70.4)	(73.7)	(76.2)
Shareholders' equity		476.2	494.3	412.6	409.0	423.1
CASH FLOW						
Op Cash Flow before WC and tax		58.9	80.9	(30.0)	56.2	78.6
Working capital		(29.7)	(25.7)	25.5	10.3	0.9
Exceptional & other		0.3	(8.8)	(0.6)	0.0	0.0
Tax		(24.4)	(9.7)	(15.0)	(17.3)	(24.0)
Net operating cash flow		5.1	36.7	(20.166)	49.2	55.5
Capex		(29.0)	(30.8)	(8.6)	(20.0)	(38.8)
Acquisitions/disposals		77.4	35.2	0.1	0.0	0.0
Net interest		(4.4)	(3.3)	(4.1)	(4.7)	(2.3)
Equity financing		(4.7)	(14.4)	(0.2)	0.0	0.0
Dividends		(5.9)	0.0	0.0	(3.3)	(7.1)
Other		(2.9)	(7.8)	(5.0)	0.0	0.0
Net Cash Flow		35.6	15.6	(38.1)	21.3	7.3
Opening net debt/(cash)		25.7	(9.8)	(25.4)	12.6	(8.6)
FX		(0.1)	0.0	0.1	0.0	0.0
Other non-cash movements		0.0	0.0	0.0	0.0	0.0
Closing net debt/(cash)		(9.8)	(25.4)	12.6	(8.6)	(15.9)

Source: Company accounts, Edison Investment Research

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