

Gemfields Group

Strong November emerald auction

Quarterly update

Metals & mining

Gemfields' November high-quality emerald auction sale of US\$27.2m reflects strong demand for Kagem's emeralds and, more broadly, points to continued strength in the coloured gemstone market. Completion of the buyback of 143m shares is the key driver of an increase in our sum-of-the-parts valuation to ZAR5.65 per share (from R5.27/share previously).

Year end	Revenue (US\$m)	PBT* (US\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/17	81.7	55.8	3.9	0.0	2.9	N/A
12/18	206.1	(22.5)	(2.3)	0.0	N/A	N/A
12/19e	195.3	25.4	0.5	0.8	22.7	7.1
12/20e	216.2	28.9	0.3	0.0	37.8	N/A

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

Latest HQ emerald auction achieved record price

Gemfields high-quality (HQ) emerald auction held in November in Singapore achieved the highest price per carat to date of US\$85.26/ct. Total sales of US\$27.2m came in well ahead of our US\$23m forecast and we have adjusted our 2019 forecasts accordingly. In our last note, [Coloured gemstones outperforming diamonds](#), published on 26 September 2019, we highlighted the strength of the coloured gemstone market, and this latest positive auction result continues to underline the positive trend. The next ruby auction will take place in December.

Change of chairman improves board independence

On 25 November, board director Martin Tolcher took over from Brian Gilbertson as chairman of Gemfields. This move aims to address any concerns about the father-son relationship between the former chairman and CEO Sean Gilbertson ahead of a potential AIM listing.

Share buyback has a positive impact on valuation

The buyback of 143m shares (at an average price of ZAR1.50/share) has a positive impact of approximately 9% on our per-share valuation. Our updated valuation of ZAR5.65/share also takes into account the (relatively minor) positive impact of higher 2019 auction revenues at Kagem and the (negative) impact on the per-share valuation of the stronger rand (currently ZAR14.73/US\$ vs ZAR14.99/US\$ previously).

3 December 2019

Price **ZAR1.67**

Market cap **ZAR1,956m**

ZAR14.73/US\$

Net cash (US\$m) at 30 June 2019 35.5

Shares in issue 1,171.2m

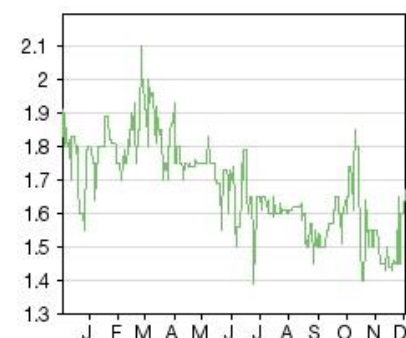
Free float 60%

Code GML

Primary exchange Johannesburg

Secondary exchange Bermuda

Share price performance



% 1m 3m 12m

Abs 7.7 8.4 (12.6)

Rel (local) 11.4 8.4 (16.9)

52-week high/low ZAR2.10 ZAR1.39

Business description

Gemfields 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

MRM auction results Mid-Dec 2019

Analyst

Alison Turner +44 (0)20 3077 5700

mining@edisongroup.com

[Edison profile page](#)

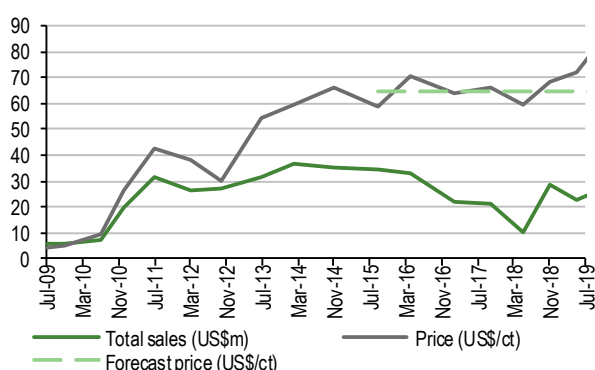
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Latest emerald auction pricing strong

Sales of US\$27.2m at Gemfields' November HQ emerald auction were well ahead of our US\$23m forecast. The auction saw 0.32m carats sold at average price of US\$85.26/ct – an all-time record for a Gemfields' emerald auction. The strength of the emerald market is further indicated by the fact that a record 48 companies placed bids in the auction, with Chinese and Israeli buyers playing a significant role in addition to Gemfields stalwart clients from India (Gemfields Company Announcement, 22 November 2019).

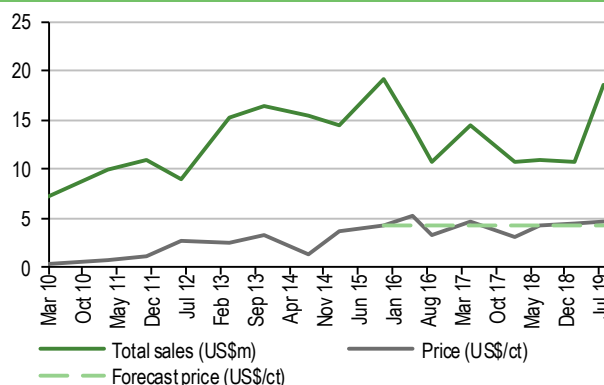
Exhibit 1 below clearly illustrates the strong upward trend in pricing at Kagem's HQ auctions over the past 10 years. We believe this reflects not only the growth of world demand for high-quality emeralds, but also the success of Gemfields' sales strategy, providing a consistent supply to the market that cutters and polishers have come to trust. The same positive trend in emerald pricing is evident in commercial-quality (CQ) auction results (Exhibit 2). Our forecasts assume a price of US\$64.63/ct for HQ emeralds and US\$4.19/ct for CQ emeralds, with both held constant over the life of mine. While our HQ price forecast (which was based on the average price achieved in the four years to 2018) may appear conservative in relation to the two most recent HQ auctions, we await confirmation on whether those higher prices will be sustained as the volume of HQ sales increases significantly (we forecast HQ sales growing to 930kcts in 2021 from 630kcts in 2019).

Exhibit 1: HQ emerald auction prices (US\$/ct) and total sales (US\$m)



Source: Gemfields

Exhibit 2: CQ emerald auction prices (US\$/ct) and total sales (US\$m)



Source: Gemfields

Although Kagem has seen a lower level of premium emeralds recovered this year relative to last, with 106kcts recovered up to August 2019 (Gemfields Investor Update Presentation, September 2019) compared to 171kcts for the same period in 2018, the impact has been more than mitigated by the stronger emerald market, which has allowed Gemfields to sell a slightly higher volume of emeralds at HQ auctions (0.63Mcts for FY19 vs 0.59Mcts in FY18) at a significantly higher price (US\$79.20/ct in 2019 vs US\$65.77/ct in 2018). This has resulted in total HQ auction revenues for Kagem of US\$49.6m in FY19 versus US\$38.7m in FY18 and overall Kagem auction revenue (including CQ auctions) of US\$79.0m in FY19 versus US\$60.4m in 2018. This total was slightly above our previous forecast of US\$74.8m for Kagem auction revenue and we have updated our FY19 revenue forecasts accordingly.

New chairman to enhance independence of this role

On 18 November, Gemfields announced that chairman Brian Gilbertson would be stepping down with effect from 25 November 2019, with the chairman role to be assumed by Martin Tolcher, who has served on the board since 25 November 2008. The change is being made to address any

governance concerns that may have arisen about the father-son relationship between Brian Gilbertson and CEO Sean Gilbertson. The appointment of an independent chairman should help pave the way for a potential AIM listing.

Positive valuation impact of share buyback

Between 11 June and 27 September 2019, Gemfields bought back 143.17m shares (approximately 10% of the issued share capital) at an average price of ZAR1.50/share, resulting in a total buyback cost of US\$14.41m. Following the completed buyback, the company has 1,267.5m shares in issue or 1,171.2m shares outstanding net of treasury shares (96.27m). As the buyback was at a price substantially lower than our per-share valuation of Gemfields, the impact on valuation is positive (adding 9% to our per-share valuation). We have also adjusted our sum-of-the-parts valuation for:

- the US\$2.6m positive impact on 2019 free cash flows of increased Kagem HQ auction revenues (as discussed above); and
- the negative impact on our per-share valuation of a stronger rand (ZAR14.73/US\$ vs ZAR14.99/US\$ previously). Our valuation is US dollar based and translated into rand at the current exchange rate.

Our updated sum-of-the-parts valuation of Gemfields is US\$449m or ZAR5.65 per share (from ZAR5.27/share previously) – significantly above the current share price of ZAR1.60.

Exhibit 3: Gemfields SOTP valuation

	New (US\$m)	Previous (US\$m)	New ZAR/share*	Previous ZAR/share
Kagem (75%)	153	152	1.92	1.73
Montepuez Ruby Mining (75%)	370	370	4.66	4.22
Fabergé	47	47	0.59	0.54
Sedibelo (6.54%)	40	40	0.50	0.45
Corporate overheads	(197)	(197)	(2.48)	(2.25)
June 2019 net cash (US\$35.5m) adjusted for remaining tranche of Jupiter sale (US\$15.0m) and cost of share buyback (US\$14.4m)	36	51	0.45	0.58
SOTP valuation	449	463	5.65	5.27

Source: Edison Investment Research. Note: Value per share is stated after adjusting for Gemfields' interest in its own shares (96.27m).

Potential impact of further share buyback if approved

As announced in April 2019, following the sale of its stake in Jupiter Mines, Gemfields earmarked a distribution pool of US\$24.685m to be returned to shareholders. After the US\$14.4m buyback now completed, US\$10.28m of the distribution pool remains and it is Gemfields' intention to use this for further share buybacks (subject to shareholder approval at the 4 December extraordinary general meeting). Given the steep discount at which Gemfields' shares are trading relative to our valuation, this would be value accretive on our numbers. In Exhibit 4 below, we show the valuation per share before any further share buyback, and then the potential impact of a buyback of half the distribution pool (US\$5.14m) or the full distribution pool (US\$10.28m) assuming shares are bought back at the current price of ZAR1.60/share.

Exhibit 4: Potential impact of further share buyback on valuation (at ZAR1.60/share)

Further share buyback	None	US\$5.14m	US\$10.28m
Valuation (ZAR/share)	ZAR5.65	ZAR5.82	ZAR6.01

Source: Edison Investment Research analysis

Sensitivities

The key risks facing Gemfields are country and fiscal in Mozambique and Zambia, market risks relating to the coloured gemstone market and variability in the recovery of premium rubies and emeralds at Montepuez and Kagem respectively.

- **Country and fiscal risk:** Gemfields' key assets are in Mozambique and Zambia and are subject to the political, security and fiscal risks associated with these jurisdictions. Zambia introduced a 15% export tax on emeralds in 2019, which remains subject to discussion between the industry and government (but which remains in force and has been fully taken into account in our forecasts).
- **Coloured gemstone market risk:** we forecast 7% CAGR in auction sales to 2028e and, while all signs point to a growing coloured gemstone market able to absorb that supply, this remains a key risk. Market demand is likewise a key risk for Fabergé's growth.
- **Variability in premium emerald and ruby recoveries:** the nature of gemstone mining is that the recovery of high-value 'premium' emeralds and rubies can vary significantly within the orebodies. Although unexpected negative and positive variations should broadly balance, in the short term this variability constitutes a key risk.

Financials

We have updated our 2019 forecasts to reflect higher than expected HQ auction revenues for Kagem adding US\$4.2m to 2019 revenue and US\$3.2m to 2019 EBITDA. Our longer-term forecasts are unchanged (other than the minor impact of closing inventory and other balances).

Exhibit 5: Group 2019 key metrics (previous and new forecasts)

(US\$m)	2019e	
	Previous	New
Revenue	191.1	195.3
EBITDA	49.9	53.1
PBT*	22.2	25.4
EPS (c)	0.4	0.5

Source: Gemfields, Edison Investment Research analysis. Note: *PBT is normalised, before share-based payments.

We expect Gemfields to end 2019 with net cash of US\$47.0m

As at 30 June 2019 Gemfields had net cash of US\$35.5m and we expect that to increase to US\$47.0m by year end.

Exhibit 6: Financial summary

	\$m	2016	2017	2018	2019e	2020e	2021e	2022e	2023e
31-December		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT									
Revenue		0.0	81.7	206.1	195.3	216.2	258.1	271.4	288.8
Cost of Sales		0.0	(44.3)	(123.5)	(120.9)	(132.4)	(124.9)	(151.3)	(147.7)
Gross Profit		0.0	37.3	82.5	74.4	83.8	133.2	120.1	141.0
EBITDA		(5.9)	30.5	58.9	53.1	58.8	100.9	85.2	103.9
Normalised operating profit		(5.9)	8.3	28.2	21.9	28.9	73.5	59.3	78.8
Fair value gains (losses)		50.4	49.5	(41.9)	7.3	0.0	0.0	0.0	0.0
Exceptionals		0.0	0.0	(22.6)	0.0	0.0	0.0	0.0	0.0
Share-based payments		0.0	(2.7)	(4.2)	(3.0)	(3.0)	(3.0)	(3.0)	(3.0)
Reported operating profit		44.5	55.1	(40.4)	26.2	25.9	70.5	56.3	75.8
Net Interest		0.0	(2.0)	(8.8)	(3.8)	0.0	0.4	1.4	2.6
Joint ventures & associates (post tax)		0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Profit Before Tax (norm)		44.6	55.8	(22.5)	25.4	28.9	74.0	60.7	81.4
Profit Before Tax (reported)		44.6	53.1	(53.9)	22.4	25.9	71.0	57.7	78.4
Reported tax		(0.0)	(7.6)	(6.5)	(16.2)	(21.2)	(31.0)	(33.4)	(38.2)
Profit After Tax (norm)		44.6	48.2	(29.0)	9.2	7.8	43.0	27.3	43.2
Profit After Tax (reported)		44.6	45.5	(60.4)	6.2	4.8	40.0	24.3	40.2
Minority interests		0.0	(7.2)	(1.8)	(2.6)	(4.8)	(8.8)	(10.1)	(12.5)
Discontinued operations		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)		44.6	41.0	(30.8)	6.6	3.0	34.2	17.2	30.7
Net income (reported)		44.6	38.3	(62.2)	3.6	(0.0)	31.2	14.2	27.7
Basic average shares outstanding (m)		760	1,039	1,314	1,266	1,171	1,171	1,171	1,171
EPS - basic normalised (c)		586.1	3.9	(2.3)	0.5	0.3	2.9	1.5	2.6
EPS - diluted normalised (c)		5.9	3.9	(2.3)	0.5	0.3	2.9	1.5	2.6
EPS - basic reported (c)		5.9	3.7	(4.7)	0.3	(0.0)	2.7	1.2	2.4
Dividend (c)		0.0	0.0	0.0	0.8	0.0	0.0	0.0	0.0
Revenue growth (%)		N/A	N/A	152.4	(-5.2)	10.7	19.4	5.1	6.4
Gross Margin (%)		N/A	45.7	40.1	38.1	38.8	51.6	44.2	48.8
EBITDA Margin (%)		N/A	37.3	28.6	27.2	27.2	39.1	31.4	36.0
Normalised Operating Margin		N/A	10.2	13.7	11.2	13.4	28.5	21.9	27.3
BALANCE SHEET									
Fixed Assets		359.7	639.6	509.7	478.6	472.4	465.2	462.2	458.1
Intangible Assets		0.0	49.3	52.3	52.3	52.3	52.3	52.3	52.3
Tangible Assets		0.0	378.0	365.0	359.0	352.8	345.6	342.6	338.5
Investments & other		359.7	212.2	92.4	67.3	67.3	67.3	67.3	67.3
Current Assets		7.4	184.1	224.4	236.9	252.6	302.9	328.8	369.4
Stocks		0.0	118.8	99.2	104.6	106.2	126.5	120.1	116.6
Debtors		1.2	27.5	62.1	32.1	35.5	42.4	44.6	47.5
Cash & cash equivalents		1.2	37.8	63.0	100.1	110.9	134.0	164.1	205.4
Other		5.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current Liabilities		(0.2)	(37.0)	(60.6)	(57.3)	(60.6)	(65.5)	(66.9)	(67.8)
Creditors		(0.2)	(21.2)	(28.2)	(23.0)	(25.3)	(28.2)	(29.2)	(29.1)
Tax payable		0.0	(7.0)	(1.4)	(3.2)	(4.2)	(6.2)	(6.7)	(7.6)
Short term borrowings		0.0	(4.2)	(23.2)	(23.2)	(23.2)	(23.2)	(23.2)	(23.2)
Other		0.0	(4.6)	(7.9)	(7.9)	(7.9)	(7.9)	(7.9)	(7.9)
Long Term Liabilities		0.0	(169.6)	(123.4)	(123.4)	(123.4)	(123.4)	(123.4)	(123.4)
Long term borrowings		0.0	(59.3)	(30.0)	(30.0)	(30.0)	(30.0)	(30.0)	(30.0)
Other long-term liabilities		0.0	(110.3)	(93.4)	(93.4)	(93.4)	(93.4)	(93.4)	(93.4)
Net Assets		366.9	617.1	550.1	534.8	541.0	579.2	600.7	636.3
Minority interests		0.0	(78.4)	(73.9)	(74.2)	(75.2)	(76.8)	(78.8)	(81.5)
Shareholders' equity		366.9	538.7	476.2	460.6	465.9	502.4	521.9	554.8
CASH FLOW									
Op Cash Flow before WC and tax		(5.9)	30.5	58.9	53.1	58.8	100.9	85.2	103.9
Working capital		0.5	(9.7)	(29.7)	21.4	(1.8)	(22.3)	5.6	1.6
Exceptional & other		5.0	0.4	0.3	0.0	0.0	0.0	0.0	0.0
Tax		(0.0)	(7.6)	(24.4)	(16.9)	(21.2)	(31.0)	(33.4)	(38.2)
Net operating cash flow		(0.4)	13.6	5.1	57.7	35.9	47.6	57.4	67.3
Capex		0.0	(11.0)	(29.0)	(25.2)	(23.7)	(20.2)	(22.8)	(21.0)
Acquisitions/disposals		0.0	(17.9)	77.4	35.5	2.3	2.3	2.3	2.3
Net interest		0.0	(2.3)	(4.4)	(3.8)	0.0	0.4	1.4	2.6
Equity financing		0.0	(0.7)	(4.7)	(14.4)	0.0	0.0	0.0	0.0
Dividends		0.0	(5.0)	(5.9)	(12.6)	(3.8)	(7.1)	(8.1)	(9.9)
Other		0.0	(3.4)	(2.9)	0.0	0.0	0.0	0.0	0.0
Net Cash Flow		(0.4)	(26.6)	35.7	37.2	10.7	23.1	30.1	41.3
Opening net debt/(cash)		0.0	(1.2)	25.7	(9.8)	(47.0)	(57.7)	(80.8)	(110.9)
FX		0.0	(0.3)	(0.1)	0.0	0.0	0.0	0.0	0.0
Other non-cash movements		1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Closing net debt/(cash)		(1.2)	25.7	(9.8)	(47.0)	(57.7)	(80.8)	(110.9)	(152.2)

Source: Gemfields, Edison Investment Research forecasts

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Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1,185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia