

Sumatra Copper & Gold (SUM)

SUM financed; scope up to 100koz/yr v. 55koz/yr in our valuation of 29c/share

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Three Key Points

- Julian Ford, CEO of SUM, is doing the east coast marketing round this week, highlighting the final opportunity to buy in ahead of the under-written 1 for 3 rights issue, proposed to be at 20c/share.
- The extra equity being raised is to allow deeper drilling earlier to define a high grade resource for under-ground mining to give the potential to produce up to 100koz/yr at \$300/oz, compared with 55koz at \$600/oz, which is the basis of our valuation of 29c/share
- The rights issue will open as soon as the final forestry permit is granted, which is expected by 28 March. This will be the last chance to acquire a position, other than bidding on market.

SUM presentation – key points

SUM fully financed to develop Tembang project

- SUM announced, on 22 February, that it had secured the required equity funding, through a placement of its major shareholder, Provident Capital, placing 38m at 22c/share.
- Provident Capital and associates will increase their holding in SUM from 31% to 40% as a result of this placement.
- SUM will then undertake a 1 for 3 rights issue to eligible shareholders, under-written by Provident Capital.

Forestry Approval expected by 28 March

- The approvals system now has fixed processing times. The time from lodgement of the final application to its approval is a maximum of 45 days, which is 28 March.
- We expect that approval will come before then as SUM is well connected into the approvals process and a major shareholder has good connections with the Minister

Extra equity being raised

- Pre-production capital is \$40m, of which \$30m is senior debt. A further \$5m is needed to re-pay some debt and some more for working capital.
- The total equity raising, of \$28m - \$38m, should allow SUM to work on a revised mine plan, to be completed around the end of 2014, after Tembang has been in operation.
- The key will be higher grade at depth, which is normal for low sulphidation epithermal gold deposits, and the potential for higher grade under-ground mining.

Investment View

- By processing higher grade, under-ground ores, Tembang could change from 55koz/yr at \$600/oz to up to 100koz/yr at \$400.oz., which would increase our base case valuation to 49c/share.
- The Tembang project is not technically difficult and SUM has been able to manage the risk very well.
- There is significant upside potential to our valuation and we retain a Buy recommendation on SUM.

Recommendation

Buy

Previous Recommendation	Strong Buy
Risk Rating	High
Current Share Price	\$0.22
12 Month Price Target	\$0.29 (from \$0.34)
Price Target Methodology	DCF
Total Return (Capital + Yield)	31.3%
NAV / Share	\$0.29 (from \$0.34)
Market capitalisation	\$57m
Liquidity – Daily Value	\$0.1m

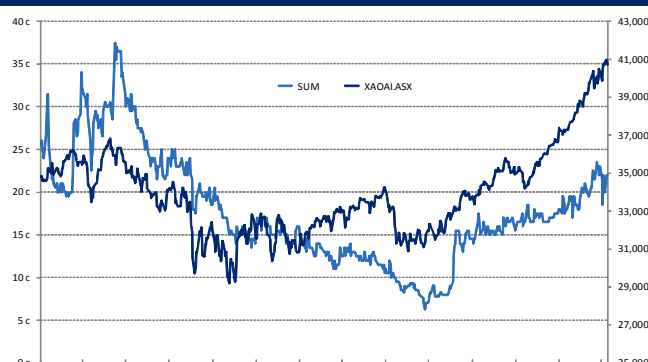


Financial Forecasts & Valuation Metrics

Y/e Dec (\$m)	2011A	2012F	2013F	2014F
Revenue	0	0	0	42
NPAT	-5.6	-3.7	-2.0	-0.9
EPS (cps)	-3.2	-1.7	-0.5	-0.2
EPS Growth		47%	70%	54%
EV / EBITDA (x)	na	na	na	4.7
PER (x)	-6.8	-12.9	-42.5	-92.1
Gearing	-11%	-47%	-5%	-14%
Interest Cover (x)	na	na	na	0.9

Source: PhillipCapital estimates

SUM share price performance



SUM : Continuing to deliver

Major strategic milestones

On 30 May 2011, SUM announced that its founding CEO would be standing down and that Julian Ford would become CEO from 1 June, 2011. Julian changes the focus of SUM from exploration to project development, and managing the risks associated.

Technical Risk

The project had been previously mined, but was closed when the gold price was about \$300/oz. As a result, if the professionals who had previously run the mining operations could be re-engaged, the technical risk would be significantly reduced.

In September 2011, SUM announced the appointment of Grant Harding, a metallurgist who had previously worked on Kingsrose Mining's (KRM.ASX) Way Linggo project, Newcrest Mining's (NCM.ASX) Gosowong project and also managed the DFS, design and construction of Finders Resources' (FND.ASX) Wetar Copper project and project managed Avocet Mining's Bakan Gold project in north Sulawesi.

Permitting Risk

Permitting risk is an issue in Indonesia as it is still an evolving issue. There are ways to manage this risk, the most important of which is to have local people and to also understand the nature of the process which is somewhat fluid.

Adi Sjoerki is a founding Director of SUM. He lives in Jakarta and was educated at Flinders University, graduating with a degree in geology, before working for CSR Mining, developing the Tembang project, and then Newmont (NEM.N).

This is the fourth project for which Adi has secured permitting; the previous projects being NEM's Batu Hijau project, the early approvals for FND's Wetar project and G-Resources' (1051.HK) Martabe project.

The key is to engage the local people and to understand how the regulatory environment has changed since 1998 and continues to evolve.

Cornerstone investors

It is especially important in Indonesia to have rich, powerful and honest connections; it is also rare to achieve this.

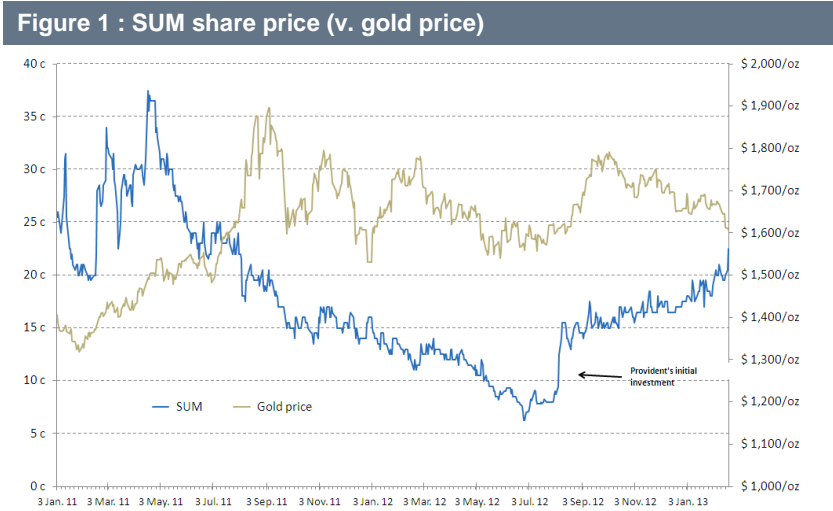
On 8 August, 2012, SUM announced that it had raised \$3.8m by a placement to Provident Capital at 13.5c/share. SUM's share price was 9.0c immediately before the announcement, having been below 7c in late July, as shown in Figure 1.

SUM has, since Julian Ford became MD in June 2011, delivered on its major milestones.

Permitting risk is a evolving, fluid issue, which SUM is able to manage as it is on the ground and also has developed food contacts

The final permit is expected by 28 March at the latest

Provident first took a placement of SUM at 13.5c/share when the stock was at 9.0oc, having been below 7.0c just days before.



Source : IRESS, PhillipCapital

As part of the deal, Provident was granted 40m options, exercisable at a discount of 15% to the 10-day VWAP, conditional upon either :

- Provident, or their nominees, having acquired an additional 10 million Shares; or
- SUM having obtained a Pinjam Pakai Eksploitasi (exploitation forestry permit) for the Tembang project.

Figure 1 shows that from the time that Provident initially bought into SUM, the share price has done well despite the sagging gold price.

Provident has introduced large investors into SUM, with some very strong connections.

Provident's Associates

Since it bought its original stake, Provident has introduced new investors to SUM :

- Garibaldi ("Boy") Thohir, an Indonesian billionaire, who is the Chief Executive and major shareholder of PT Adaro Energi, which expects to produce 50Mt to 53Mt of coal in 2013 and posted net income of US\$ 346m for 2012
 - He has invested about \$5m of his own personal money and, as should be expected, has very close contact with relevant Ministers
- PT Saratoga Investama Sedaya, which is an Indonesian Private Equity investor, run by Edwin Soeryadjaya, whose father, William, established PT Astra, a major Indonesian conglomerate, and Sandiango Uno; and
- Yaw Chee Siaw, a Singapore billionaire.

Impact of Cornerstones (i)

Figure 1 shows that the SUM share price has continued to rise since the original placement to Provident. Part of this rise was because Provident bought a further 10m shares on market so that it was able to exercise its 40m options.

The share price has continued to rise, as these investors have bought

We understand that the cornerstone investors have bought more on market since.

Impact of Cornerstones (ii)

None of Provident or its associates are on the Board of SUM. As a result, they are not restricted in their dealing in SUM shares.

Neither Provident nor any of its associates are on the Board so they are not restricted in dealing in SUM.

SUM is a plc company, which was originally AIM listed and its CDIs (CHESS Depository Instruments) trade on the ASX. As a result, it is subject to the City of London rules rather than the Corporations Act with respect to matters relating to take-over. This has 2 significant impacts :

- While under Australian interpretations, the "Indonesian" interests would be deemed to be associates, they are not under the City Code; and
- Each can acquire up to 30% of SUM before it can be forced to make a follow-on bid.

Provident and its associates are each permitted to buy up to 30% of SUM before making a follow on bid

As there are 4 parties, this means that each is able to continue to acquire stock and between them they are able to acquire 100% without making a bid.

Impact of Cornerstones (iii)

We understand that the cornerstone investors are not "strategic" investors and will want to receive a dividend return, rather than sell stock to receive cash or just hold equity in a mining company for the intrinsic value.

Last chance to invest in size

Provident recently took a placement at 22c//share, while we expect that the rights issue, which is fully under-written, will be around 20c/share.

Pre-production capital is \$40m, of which \$30m is senior debt. A further \$5m is needed to re-pay some debt and some more for working capital. So the total minimum equity required is \$20m.

The raising is an under-written rights issue.

This is felt by the company management to be the fairest way to existing shareholders, especially as a small group of the existing shareholders are prepared to subscribe all of the required equity themselves. The raising is under-written by this same group of existing investors.

The rights issue will be one for three for eligible shareholders. The pricing has not yet been set, however, SUM placed stock with tis cornerstones at 22c/share.

We expect that the new equity will be priced around 20c/share.

No more equity will be required to develop Tembang.

SUM will not need any further equity after this rights issue, which will be as soon as the final permit is issued (28 March at the latest).

If an investor wishes to acquire a position in SUM, it needs to buy on-market now, before the rights entitlement will be settled, which will be about the end of March, in 2 weeks.

Potential project enhancement

Tembang project : BFS case

As CEO, Julian Ford moved very quickly to get into production

As a result, financing has been based on the information that was available, rather than spending a lot more time and money on feasibility studies, and run the risk of not being able to raise funds in a tough market

As shown in Figure 2, the Tembang project has been previously mined.

When Julian Ford became CEO, in June 2011, he focussed on getting a project into operation as quickly as possible.

A PFS was produced in February 2012, focussed on that part of the project for which there was sufficient information.

A DFS for that part of the project was announced in September 2012, while a PFS for the balance of the project was also announced in September.

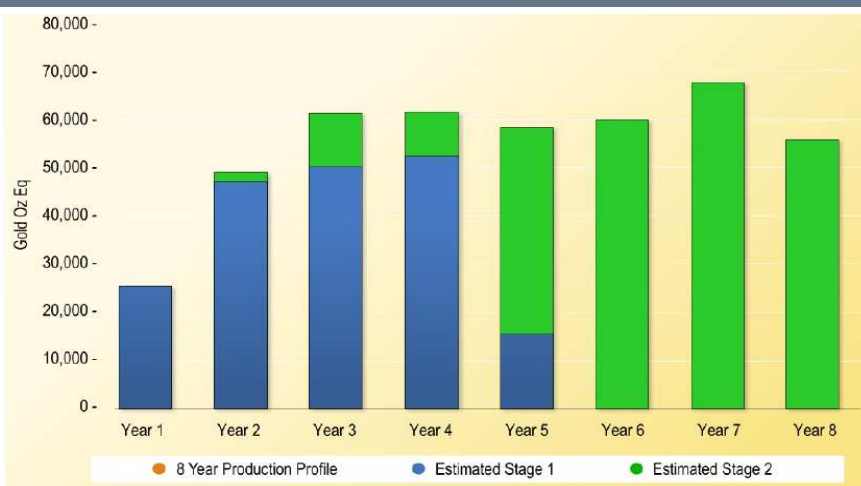
Figure 2 : Tembang project



Source : SUM presentation, January 2013

Figure 3 shows the result. Stage 1 provided sufficient security for the debt funding and sufficient cashflow, after re-paying the debt to develop stage 2.

Figure 3 : Stage 1 DFS and Stage 2 PFS expected production



Source : SUM presentation, January 2013

As a result, there is good potential to improve the project

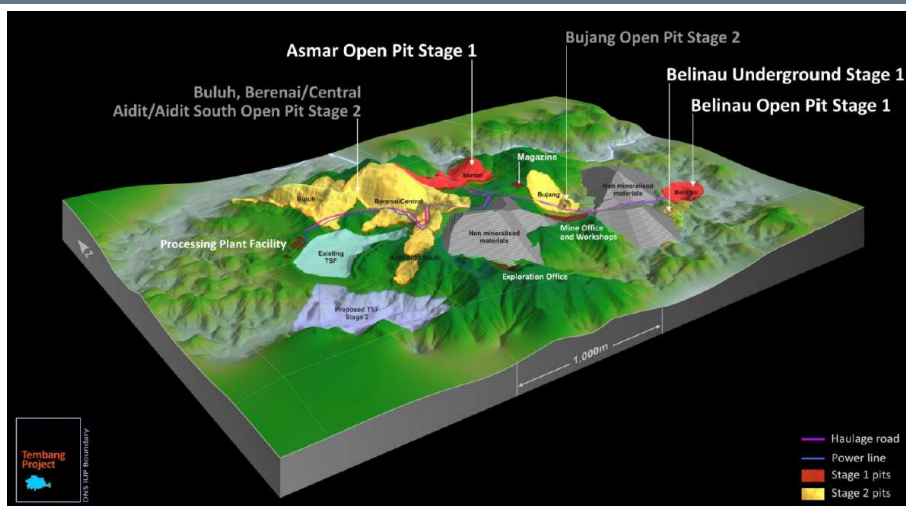
There is significant potential to mine resources in stage 2 as under-ground operations, focussing on higher grade ore

Potential changes to BFS / PFS case

Figure 4 shows the mine plan from the DFS and the PFS. It shows that the mine plan has a small under-ground mine at Belinau, and that the rest of the resources are intended to be extracted by open cut mining.

The mining success at KRM's Way Linggo mine suggests that while an open cut might be easier to scope, under-ground mining can more successfully extract relatively small but high grade lodes. It will require more drilling to be able to define the under-ground potential at Aidit / Aidit South and also Bjuang which could well become under-ground mining operations. However, with the excess equity raising, SUM has the means with which to do this.

Figure 4 : Tembang project

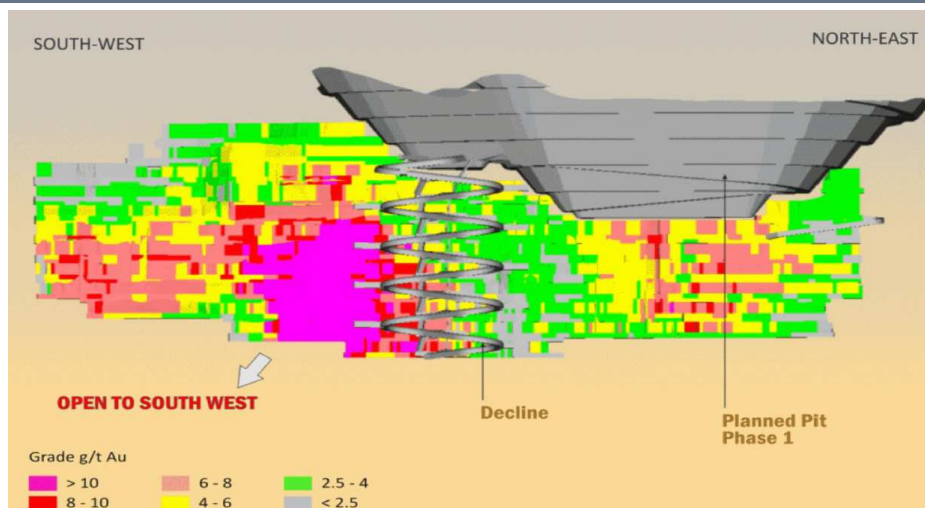


Source : SUM presentation, January 2013

There is significant potential for higher grade ore at Belinau

Figure 5 shows the plan for Belinau. It shows that the drilling has been to only 200m deep in sufficient density to define a Resource. It suggests that the grade increases with depth.

Figure 5 : Belinau pit



Source : SUM presentation, January 2013

Figure 5 also shows that there appears to be a high grade shoot, to the south-west of the pit, that is open at depth. Typically, a low sulphidation epithermal gold deposit is about twice as long as it is deep. Belinau is 800m long suggesting a depth of 400m, which is twice that shown in Figure 5.

Impact of potential changes

The changes could increase production to 100koz/yr at lower cash costs

We have tested the sensitivity of our model results to a greater volume of under-ground ore.

While the company indicated the potential for 100koz of gold equivalent at about \$300/oz of gold, we :

- (i). Increased the volume of under-ground ore, by 1.0Mt, from 569kt presently; and
- (ii). Increased the amount of under-ground ore fed to the mill, from 140kt/yr during the 400kt/yr stage 1 phase, to 600kt/yr during the 900kt/yr stage 2 phase, with the open cut ore being used as a filler.

This increased our production in the medium term from 55koz gold at \$450 - \$500/oz to about 100koz/yr of gold, or 120koz/yr of Au-eq, at \$400/oz of gold.

Our modelling gives realistic scope for a valuation of 50c/share, but this is speculative at this stage.

The small change in the cash cost is due to

- The higher cost of mining under-ground ore; and
- Our assumption that the silver grades do not change.

Together, these increased our valuation from 29c to 43c.

We then added 1.0g/t to the grade of the under-ground ore, raising it from 5.1g/t to 6.1g/t. This further increased our valuation from 43c to 49c.

Figure 5 suggests that the grade from Belinau should be more like 10g/t than 6g/t. This suggests significant further upside potential; with each extra 1.0g/t adding a further 6c/share to our risked valuation.

Conclusions

We retain a Buy recommendation as our base case is more than 30% above the share price and there is significant upside potential.

SUM expect to have a revised mine plan by the end of 2014. At this time, we are not changing our base case valuation.

We retain a Buy recommendation as our base case valuation is more than 30% above the share price.

We also see significant upside potential in SUM from the change in the mine plan to focus on higher grade under-ground ores.

There is also upside form continued de-risking of the project.

These are shown in Figure 6.

Figure 6 : Sensitivity of valuation

	<u>Base Case</u>	<u>Upside case</u>
Base Case	29 c	49 c
Un-risked	33 c	55 c

Source : PhillipCapital estimates

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Recommendation Criteria

Investment View

PhillipCapital Investment View is based on an absolute 1-year total return equal to capital appreciation plus yield.

Buy	Hold	Sell
>20%	20% – 5%	<5%

A Speculative recommendation is when a company has limited experience from which to derive a fundamental investment view.

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