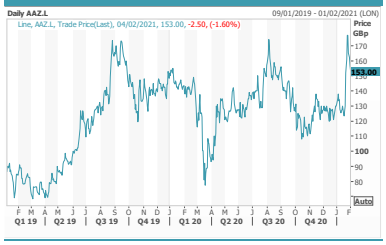
Mining



Source: Refinitiv

Market data

EPIC/TKR	**AAZ**
Price (p)	**156.4**
12m High (p)	181.8
12m Low (p)	68.8
Shares (m)	114.4
Mkt Cap (£m)	178.9
EV (£m)	153.4
Free Float*	58.95%
Market	AIM

**As defined by AIM Rule 26*

Description

Anglo Asian Mining (AAZ) operates three mines and downstream processing facilities at its main site at Gedabek in Azerbaijan. Besides further exploration potential at Gedabek, exploration work has begun at the 462 sq km prospect at Ordubad.

Company information

CEO	Reza Vaziri
CFO	Bill Morgan
COO	Khosrow Zamani

+ 994 12 596 3350
www.angloasianmining.com

Key shareholders

Directors & Management	41.05%

Diary

Feb'21	4Q'20 exploration
Mar'21	Production guidance

Analyst

Paul Mylchreest 020 3693 7075
pm@hardmanandco.com

ANGLO ASIAN MINING

Prodigious cash generation – REDUX

AAZ is a highly cash-generative miner of gold, silver and copper from three mines in Azerbaijan, where it has a track record of close cooperation with the government. The company listed on AIM in 2005, produced its first gold in 2009, paid a maiden dividend in 2018 and produced 69,091 Gold Equivalent Ounces (GEOs) in 2020 (at budgeted metal prices). AAZ is progressing multiple projects to expand production at its flagship Gedabek and others (see below) in Azerbaijan and (potentially) Ireland. We will review our DCF valuation of 181p per share following AAZ's production guidance update expected in March 2021.

- **2020 challenges negotiated:** Despite the combination of COVID-19, the July-November hostilities with Armenia and lower mining activity at the nearly exhausted Ugur deposit, AAZ achieved an 8% shortfall versus the lower end of its 75k-80k GEOs production guidance in 2020.
- **Production upside:** There are a potential underground mine and five exploration targets at Gedabek, the first of which could come onstream as early as 2022. Behind these are the Ordubad contract area, three licence areas in the restored territories after the conflict, and a potential joint venture in Ireland.
- **Potential for two major mineral "systems":** We believe that AAZ's flagship Gedabek contract area could be part of a much bigger epithermal-porphyry system of gold-silver-copper mineralisation. Exploration work is accelerating at the untapped Ordubad project – potentially a significant copper-gold porphyry.
- **Risks:** AAZ faces the normal risks for a junior miner, albeit without the funding risk faced by explorers/developers. These include volatility in gold prices, political risks (albeit mitigated), environmental risks, and operational risks in successfully executing the mining plan and operating downstream processing facilities.
- **Investment summary**: Our current DCF-based valuation of 181p per share (8% discount rate) is under review, pending upcoming guidance on the production and operational outlook in the wake of last year's challenges. While the near-term production outlook may be slightly lower than our previous forecasts, our valuation is currently based on a conservative long-term gold price of $1,600/oz.

Financial summary and valuation

Year-end Dec ($m)	2017	2018	2019	2020E	2021E	2022E
Sales	71.81	90.35	92.05	103.20	111.42	112.81
Underlying EBIT	9.22	26.82	31.33	34.57	43.05	40.41
Reported EBIT	9.22	26.82	31.33	34.57	41.45	40.41
Underlying PTP	5.68	25.25	30.13	34.70	41.98	41.16
Statutory PTP	5.68	25.25	30.13	34.70	41.98	41.16
Underlying EPS (c)	2.22	14.32	16.91	19.71	23.85	23.38
Statutory EPS (c)	2.22	14.32	16.91	19.71	23.85	23.38
Net (debt)/cash	-18.12	6.10	16.11	35.0	n/a	n/a
Shares issued (m)	113.3	114.4	114.4	114.4	114.4	114.4
P/E (x)	96.0	14.9	12.6	10.8	8.9	9.1
Dividend yield	n/a	3.3%	3.8%	2.8%	3.8%	3.8%
FCF yield	6.1%	8.7%	12.0%	12.8%	13.0%	12.9%

Source: Hardman & Co Research

Investment case – in brief

AAZ's headquarters in Baku and mining operation in Western Azerbaijan

AAZ was listed on London's AIM market in 2005 to develop a gold and copper joint venture with the Government of Azerbaijan (GoA). AAZ is headquartered in the capital, Baku, and its mining operations are located in the Lesser Caucasus area in the west of the country. These include the Gedabak operation – which extends over 300 sq km - and the small (currently) Gosha operation 50km to the north west. The company also has the potentially significant Ordubad project, close to the town of Ordubad, the second-largest in the Nakchivan autonomous region of Azerbaijan. There are also three targets in the now restored (but formerly Armenian-occupied) territories.

Anglo Asian Mining: location of mines and deposits in Azerbaijan

Source: Anglo Asian Mining

Gedabek is AAZ's flagship site, with three operating mines

The three primary mines currently operating in the Gedabek contract area are:

- **Gedabek open pit,** which has been producing gold, silver and copper since 2009;
- **Ugur open pit,** which was fast-tracked (less than a year) into gold and silver production in September 2017, but is now nearly mined out; and
- **Gadir underground mine,** which has been producing gold since 2015.

In 2020, AAZ produced 69,091 GEOs at budgeted metal prices, which was below the guidance of 75,000-80,000 GEOs. Owing to the increase in gold relative to copper versus budgeted prices, production was 67,249 GEOs at actual prices.

AAZ is highly cash-generative and is in the first quartile of the industry

What sets AAZ apart from the vast majority of its peers is its prodigious cash generation, which is due primarily to its low cost of production. This, in turn, is due to the combination of a number of factors:

- its Azerbaijani jurisdiction;
- predominance of open pit mining;
- access to the national power grid;

- modest levels of reinvestment; and
- investment in efficient downstream processing facilities.

AAZ's full year (FY) 2019 figure for All-In Sustaining Costs (AISC) was $591/oz, versus $541/oz in FY'18, putting it comfortably in the industry's first quartile. The shortfall in 2020 production due to COVID-19 and the conflict with Armenia led to a spike in AISC to $743/oz in 1H'20, although we expect a slightly lower figure in 2H'20 and a decline in FY'21 as production rebounds.

AAZ ended 2020 with ca.$35m net cash

It has also enabled AAZ's balance sheet to move from a net debt position of $52.4m at end-December 2014 to a net cash position (excluding leases) of ca.$35.0m at end-December 2020, without any capital raisings. This was in spite of the company declaring dividends since its 2018 interims. Indeed, the company has committed to paying a dividend equivalent to 25% of its free cashflow (net cashflow from operations less capex) going forward.

2021 guidance next month

Guidance on the 2021 production outlook, likely with an update on operational issues, is due in early March. The company has noted that the impact of COVID-19 is now minimal, and peace between Azerbaijan and Amenia was negotiated in November 2020 and will be enforced by the Russian military. We are provisionally expecting production in terms of GEOs to rebound to 76,355 oz (67,249 oz). This includes an estimated 6,445 oz from the Ugur open pit as it is mined out.

Updated mineral resources and reserves statement for Gedabek open pit, Gadir and Ugur

In November 2020, AAZ announced an update for its resources and reserves for the Gedabek open pit (including stockpiled ore) and Gadir mines, and provided clarification of the residual gold and silver ounces from the Ugur open pit as it nears exhaustion (included in Measured resources and Proved reserves). Our long-term AAZ forecasts have assumed that 100% of the Measured & Indicated (M&I) resources are mined by 2030.

Total Anglo Asian Mining mineral resources & reserves

	Gold oz	Silver oz	Copper kt	Zinc kt
Measured	504,940	1,658,700	20,831	50,307
Indicated	265,000	911,000	14,593	22,388
M&I	**769,940**	**2,569,700**	**35,424**	**72,695**
Inferred	240,000	257,000	7,959	21,095
Total resources	**1,009,940**	**2,826,700**	**43,383**	**93,790**
Proved	229,940	993,000	15,473	
Probable	89,000	577,000	8,518	
Stockpile	21,000	279,000	2,200	
Total reserves	**340,940**	**1,849,700**	**26,191**	

Source: Anglo Asian Mining

Ramping up exploration work

In recent years, AAZ has adopted a more aggressive approach to exploration. Expenditure on exploration rose from ca.$1.0m In 2017 to $4.5m in 2019. The strategic aims of this programme are to replace mined production, develop new mineral deposits (where possible that can be rapidly developed into operating mines like Ugur) and to extend mine life to a minimum of 10 years.

AAZ is progressing multiple projects to expand production

In 2021, the company's resources are likely to be increased by the publication of a maiden resource estimate for a potential underground mine beneath the Gedabek open pit. There are also multiple other potential projects that should boost AAZ's production in the coming years, including:

- five targets identified in the Gedabek Contract Area (see below);

- the Gosha mine produced only a few hundred ounces of gold in 2020, but new mineralisation – including a high-grade gold vein system – has been identified;
- exploration activities are ramping up at the 462 sq km Ordubad Contract Area (which was originally going to be the site of AAZ's first mine following IPO);
- following the end of hostilities with Armenia, AAZ will begin evaluating its three licence areas – Vejnaly, Soutely and Gyzilbulakh – in partnership with the GoA in the restored territories; and
- a potential joint venture with Conroy Gold to develop the 800 sq km Longford Down Massif gold project. This includes the Clontibret deposit, which has a 500,000 oz JORC resource.

Five targets being explored at Gedabek

In May 2020, AAZ published a "Strategic Update", a key part of which was the identification of five exploration targets in the Gedabek Contract Area, which the company plans to fast-track into production within three years.

- **Avshancli 1 and Avshancli 3** – in the north east of the Gedabek Contract Area;
- **Gilar** – also in the north east of the Gedabek Contract Area;
- **Zefer** – near the leach pad processing area at Gedabek; and
- **Ugur Deeps** – several hundred metres from the south east flanks of the Ugur open pit mine.

Both Gedabek and Ordubad could be major mineralised "systems"

The most advanced of these – the Avshancli 1 gold-copper deposit - could be onstream in 2022. We have stated before that the Gedabek Contract Area, incorporating Gedabek, Gadir, Ugur and the targets above, has bigger "system" potential. We are referring to the likelihood that Gedabek-Gadir is part of a much bigger porphyry-epithermal system of gold-copper-silver mineralisation, which goes well beyond the existing resources/reserves and the next upgrade noted above. We want to emphasise that, although it is early days, the Ordubad Contact Area has similar potential, as we outline below.

Effective royalty of 12.5% based on production-sharing agreement

Under the production-sharing agreement, GoA is entitled to 51% of "profit production", i.e. the value of production less cash operating and capital costs. The agreement is subject to a minimum of 25% of the 51%, i.e. 12.75%, until all costs are recovered. This has been the royalty rate every year; with $94.6m of unrecovered costs outstanding at end-2017, it is likely to remain so until at least 2023, according to the company. The production-sharing agreement is based on similar contracts to those that have been successfully used in the development of Azerbaijan's oil sector in cooperation with oil majors, such as BP.

Our assumption is that the royalty rate remains at 12.75% until the end of 2025, after which it moves up to 51% for the remainder of our forecasting period until 2030. In practice, this is likely to be conservative because the capital costs of constructing an underground mine at Gedabek (not currently in our model) will delay the onset of higher royalty rates. The total unrecovered costs for the Gedabek and Gosha contract areas at 30 June 2020 were $52.7m and $26.4m, respectively (31 December 2019: $59.0m and $25.5m, respectively).

Our DCF valuation of 181p per share is under review

Our current DCF-based valuation, using a discount rate of 8%, of 181p per share is under review, as we await next month's update to the company's guidance. While the near-term production outlook may be slightly lower than our previous forecasts, our valuation is currently based on conservative long-term gold, silver and copper prices of $1,600/oz, $20.00/oz and $6,000/tonne, respectively.

Disclaimer

Hardman & Co provides professional independent research services and all information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable. However, no guarantee, warranty or representation, express or implied, can be given by Hardman & Co as to the accuracy, adequacy or completeness of the information contained in this research and they are not responsible for any errors or omissions or results obtained from use of such information. Neither Hardman & Co, nor any affiliates, officers, directors or employees accept any liability or responsibility in respect of the information which is subject to change without notice and may only be correct at the stated date of their issue, except in the case of gross negligence, fraud or wilful misconduct. In no event will Hardman & Co, its affiliates or any such parties be liable to you for any direct, special, indirect, consequential, incidental damages or any other damages of any kind even if Hardman & Co has been advised of the possibility thereof.

This research has been prepared purely for information purposes, and nothing in this report should be construed as an offer, or the solicitation of an offer, to buy or sell any security, product, service or investment. The research reflects the objective views of the analyst(s) named on the front page and does not constitute investment advice. However, the companies or legal entities covered in this research may pay us a fixed fee in order for this research to be made available. A full list of companies or legal entities that have paid us for coverage within the past 12 months can be viewed at http://www.hardmanandco.com/legals/research-disclosures. Hardman may provide other investment banking services to the companies or legal entities mentioned in this report.

Hardman & Co has a personal dealing policy which restricts staff and consultants' dealing in shares, bonds or other related instruments of companies or legal entities which pay Hardman & Co for any services, including research. No Hardman & Co staff, consultants or officers are employed or engaged by the companies or legal entities covered by this document in any capacity other than through Hardman & Co.

Hardman & Co does not buy or sell shares, either for their own account or for other parties and neither do they undertake investment business. We may provide investment banking services to corporate clients. Hardman & Co does not make recommendations. Accordingly, they do not publish records of their past recommendations. Where a Fair Value price is given in a research note, such as a DCF or peer comparison, this is the theoretical result of a study of a range of possible outcomes, and not a forecast of a likely share price. Hardman & Co may publish further notes on these securities, companies and legal entities but has no scheduled commitment and may cease to follow these securities, companies and legal entities without notice.

The information provided in this document is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Hardman & Co or its affiliates to any registration requirement within such jurisdiction or country.

Some or all alternative investments may not be suitable for certain investors. Investments in small and mid-cap corporations and foreign entities are speculative and involve a high degree of risk. An investor could lose all or a substantial amount of his or her investment. Investments may be leveraged and performance may be volatile; they may have high fees and expenses that reduce returns. Securities or legal entities mentioned in this document may not be suitable or appropriate for all investors. Where this document refers to a particular tax treatment, the tax treatment will depend on each investor's particular circumstances and may be subject to future change. Each investor's particular needs, investment objectives and financial situation were not taken into account in the preparation of this document and the material contained herein. Each investor must make his or her own independent decisions and obtain their own independent advice regarding any information, projects, securities, tax treatment or financial instruments mentioned herein. The fact that Hardman & Co has made available through this document various information constitutes neither a recommendation to enter into a particular transaction nor a representation that any financial instrument is suitable or appropriate for you. Each investor should consider whether an investment strategy of the purchase or sale of any product or security is appropriate for them in the light of their investment needs, objectives and financial circumstances.

This document constitutes a 'financial promotion' for the purposes of section 21 Financial Services and Markets Act 2000 (United Kingdom) ('FSMA') and accordingly has been approved by Capital Markets Strategy Ltd which is authorised and regulated by the Financial Conduct Authority (FCA).

No part of this document may be reproduced, stored in a retrieval system or transmitted in any form or by any means, mechanical, photocopying, recording or otherwise, without prior permission from Hardman & Co. By accepting this document, the recipient agrees to be bound by the limitations set out in this notice. This notice shall be governed and construed in accordance with English law. Hardman Research Ltd, trading as Hardman & Co, is an appointed representative of Capital Markets Strategy Ltd and is authorised and regulated by the FCA under registration number 600843. Hardman Research Ltd is registered at Companies House with number 8256259.

(Disclaimer Version 8 – Effective from August 2018)

Status of Hardman & Co's research under MiFID II

Some professional investors, who are subject to the new MiFID II rules from 3rd January, may be unclear about the status of Hardman & Co research and, specifically, whether it can be accepted without a commercial arrangement. Hardman & Co's research is paid for by the companies, legal entities and issuers about which we write and, as such, falls within the scope of 'minor non-monetary benefits', as defined in the Markets in Financial Instruments Directive II.

In particular, Article 12(3) of the Directive states: 'The following benefits shall qualify as acceptable minor non-monetary benefits only if they are: (b) 'written material from a third party that is commissioned and paid for by a corporate issuer or potential issuer to promote a new issuance by the company, or where the third party firm is contractually engaged and paid by the issuer to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any investment firms wishing to receive it or to the general public…'

The fact that Hardman & Co is commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

In addition, it should be noted that MiFID II's main aim is to ensure transparency in the relationship between fund managers and brokers/suppliers, and eliminate what is termed 'inducement', whereby free research is provided to fund managers to encourage them to deal with the broker. Hardman & Co is not inducing the reader of our research to trade through us, since we do not deal in any security or legal entity.

research@hardmanandco.com

1 Frederick's Place
London
EC2R 8AE
www.hardmanandco.com

+44(0)20 3693 7075