EDISON

Gemfields Group

COVID-19 update

Cash preservation ahead of December auctions

Metals & mining

Gemfields has provided an update on the impact of COVID-19 on its business. Mining remains suspended at both MRM and Kagem and will not resume before the end of September and October, respectively. The company hopes to hold its first auctions since February in December, but that remains subject to uncertainty given travel restrictions. Gemfields ended June with cash of US$53.6m and net cash of US$9.3m, which, together with cost-cutting measures, positions it well to continue to weather the storm until the planned December auctions.

Year end	Revenue (US$m)	PBT* (US$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/18	206.1	(22.5)	(2.6)	0.0	N/A	N/A
12/19	216.2	55.9	1.3	0.0	6.4	N/A
12/20e	62.1	(38.0)	(2.7)	0.0	N/A	N/A
12/21e	212.4	27.4	(0.0)	0.0	N/A	N/A

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

Auction sales now planned for December

In April, Gemfields guided that because of COVID-19 it would be unable to hold May emerald and June ruby auctions, and the next auction sales were planned for early Q4. That has now been further deferred, with Gemfields planning a high-quality emerald auction and a ruby auction in December, if possible. Only one auction took place in H1 and group revenue totalled US$15.0m (down 83% y-o-y).

Gemfields' mines remain suspended until Q4

Mining operations at both Kagem emerald mine in Zambia and Montepuez Ruby Mining (MRM) in Mozambique remain suspended and will not resume until at least the end of September at MRM and the end of October at Kagem. At both Kagem and MRM there is already sufficient gemstone inventory to supply the planned December auction sales. Gemfields has significantly cut costs to preserve cash as far as possible during this period, with group cash costs reduced from an average of US$12m a month in FY19 to less than US$5m a month in June 2020.

We now forecast 2020 closing net debt of US$11m

Given the prolonged COVID-19 impact, our forecasts now move closer to our previous 'slower recovery' scenario rather than our previous 'central case', albeit with some additional cost savings. We now forecast an FY20 EBITDA loss of US$10m (previously an EBITDA profit of US$11m in our central case and a US$14m loss in our slower recovery scenario). We expect Gemfields to end 2020 with net debt of US$11m (previously net cash of US$4m in our central case but US$21m net debt in our slower recovery scenario).

Valuation: Sum-of-the-parts of US$349m or 23p/share

We value Gemfields using a discounted cash flow sum-of-the-parts model. Our updated valuation is US$349m (23p or ZAR4.93 per share), compared to a previous central case valuation of US$459m and slower recovery case valuation of US$339m.

3 August 2020

Price	**ZAR1.31**
Market cap	**ZAR1,534m**
	ZAR16.51/US$
Net cash (US$m) at 30 June 2020	9.3
Shares in issue	1,171.1m
Free float	72%
Code	GML/GEM
Primary exchange	Johannesburg
Secondary exchange	AIM

Share price performance

%	1m	3m	12m
Abs	(17.6)	(22.0)	(18.1)
Rel (local)	(19.6)	(29.6)	(16.6)
52-week high/low		ZAR2.14	ZAR1.31

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.

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Gemfields Group is a research client of Edison Investment Research Limited

COVID-19 update

Gemfields has provided an update on its operations and corporate position, focusing on the company's response to COVID-19. Operations at Kagem and MRM have been suspended since March and April, respectively, and Gemfields has now extended the shutdown at MRM until 30 September and at Kagem until 31 October. Gemfields intends, if possible, to hold an emerald (higher quality) and a ruby (mixed quality) auction in December. The company ended June 2020 with cash of US$53.6m and net cash of US$9.3m. Gemfields is working to reduce costs and thus cash burn while operations are suspended; however, if auctions cannot be held in December as planned, Gemfields may need to look at options to secure additional funding.

Biggest COVID-19 risk is the inability to run gemstone auctions

Gemfields generates more than 90% of its revenues from emerald and ruby auctions usually comprising two high-quality (HQ) emerald auctions (May and November, usually in Singapore), two commercial-quality (CQ) emerald auctions (February and August, usually in Lusaka) and two mixed-quality (MQ) ruby auctions (June and December, usually in Singapore). The challenge from a practical perspective is that these auctions rely on customers travelling from multiple countries to carefully inspect the stones and determine the value of their bids. This process cannot take place remotely without providing the customers physical access to the stones. For Gemfields to hold auctions thus requires the lifting of worldwide travel restrictions to the extent required to allow movement of both stones and customers between countries.

As previously guided, Gemfields held just one gemstone auction in the first half of the year with no May/June auctions held and H1 group revenue totalled US$15.0m (down 83% y-o-y). However, where previously the intention was to hold both emerald and ruby auctions in October, the company now intends to hold an HQ emerald auction and an MQ ruby auction in December. MRM presently has sufficient inventory to support one MQ ruby auction and Kagem presently has sufficient inventory to support one HQ and one CQ emerald auction. As such the planned December auctions are not dependent on the resumption of production by the fourth quarter.

Rising COVID-19 case numbers in a number of countries globally have seen renewed border closures and/or quarantine requirements recently, and thus as yet there is uncertainty as to when auctions may be held. The biggest risk for Gemfields currently is that significant travel restrictions still remain in place in December preventing auctions from being held this year.

Holding auctions in December rather than earlier in the quarter would also have a negative impact on closing net cash, as it is normal for a portion of auction revenues to remain as receivables for 30–40 days.

Operational impact: Mines suspended until October/November

All but critical operations at MRM in Mozambique were suspended from 22 April 2020 and are now expected to remain suspended until at least 30 September. Employees not required for critical services have been placed on suspended contracts on reduced remuneration, as have MRM's board of directors. This has reduced the overall MRM wage bill by 25%. In addition, other cost saving measures have been implemented, reducing cash operating costs from approximately US$2.6m per month in Q219 to circa US$1.8m per month in Q220. Additional cost saving measures recently implemented will further reduce cash burn at MRM. MRM has confirmed 10 cases of COVID-19 (the majority were asymptomatic), and quarantined the affected employees and their closer contacts.

Principal operations at Kagem Emerald Mine in Zambia were suspended from 30 March 2020. The sort house was partially reopened in June 2020 to clear a backlog of sorting, grading and referencing of emeralds. Mining is expected to remain suspended until at least 31 October 2020. Employees not involved in the ongoing delivery of critical services have been placed on reduced remuneration since May 2020, which has reduced the overall wage bill at Kagem by approximately 20%. In total Kagem's cost saving measures have resulted in cash operating expenditure being reduced from US$3.4m per month in Q219 to US$1.3m per month in Q220. No cases of COVID-19 have been confirmed on site. However, the company is alert to the risk posed by the significant recent rise in COVID-19 cases in Zambia, and particularly in the Copperbelt region.

Fabergé's direct retail operations at Harrods and in Houston were closed in March but have now reopened, as have the partner-operated monobrand stores in Dubai and Kiev. Most of Fabergé's multibrand customers have also re-opened and Fabergé is starting to see signs of gradual market recovery. H1 revenues were down 34% y-o-y to US$2.5m. Fabergé has reduced operating costs to US$1.7m in the quarter to June 2020 (versus US$2.4m in Q219).

Strong balance sheet and cost cutting to preserve cash

Gemfields ended 2019 with cash of US$78.2m and net cash of US$25.4m and despite the precipitous fall in revenue in the first half, the company still had cash of US$53.6m and net cash of US$9.3m at the end of June 2020, and the company has a further US$15.6m in undrawn debt facilities. That strong balance sheet position means that Gemfields remains well placed to weather the COVID-19 storm over the remainder of this year. Gemfields has also responded rapidly to cut costs, both at its mines and Fabergé as described above, and also centrally with London employees moved to a four-day week since May. Overall, group monthly cash costs have been reduced from US$12.1m across 2019 to less than US$5m in June 2020 (average monthly cash costs were under US$7m in H120).

Nevertheless, as Gemfields notes in its announcement, if hosting gemstone auctions by the end of December 2020 is unviable, additional cash maintenance measures will be implemented and the company may need to consider its options to raise additional capital.

Forecasts move closer to our 'slower recovery' case

In our April note (Still good value under varied COVID-19 scenarios) we considered three possible scenarios for the potential impact of COVID-19 on Gemfields. Our 'central case' expected that travel restrictions would ease to the extent required to allow two full-sized emerald (one CQ and one HQ) and one MQ ruby auction in early Q4. While Gemfields still hopes to hold auctions in December, these are now likely to be more selective (smaller) sales. With the global economy still suffering significant disruption from COVID-19 even as we move into the latter part of the year, we also think it now more likely that there will be a longer-term impact on gemstone demand and thus pricing (in line with our previous slower recovery case, which had assumed a 15% reduction in 2020 pricing and a 10% longer-term drop relative to pre-COVID-19 prices). Taking these factors into account, we now forecast 2020 group revenue of US$62m (vs US$102m previously in our central case and US$53m in our slower recovery case).

However, the extended suspension of operations at MRM and Kagem, as well as cost-cutting measures, mean that costs have been reduced more than previously envisaged in either our central or slower recovery cases. Capex has been deferred and we now forecast capex of US$10m against US$16m previously. We now expect Gemfields to end 2020 with net debt of US$11m compared to a previous forecast of net cash of US$4m in the central case and US$21m net debt in our slower recovery scenario.

Our longer-term forecasts are broadly in line with our previous slower recovery scenario, other than minor changes to revenue to reflect a slightly slower start to 2021 and the impact of lower inventory starting balances.

Exhibit 1: Forecast key metrics in different COVID-19 scenarios

Key metrics	New forecast	Prev – central case**	Prev – slower recovery**
Kagem HQ emerald production 2020 (kct)	529	800	759
Kagem revenue 2020 (US$m)	28	41	26
Kagem revenue 2021 (US$m)	75	90	77
Kagem revenue 2022 (US$m)	90	98	90
MRM premium ruby production 2020 (kct)	54	98	91
MRM premium ruby production 2021 (kct)	103	114	109
MRM revenue 2020 (US$m)	27	52	19
MRM revenue 2021 (US$m)	128	136	129
MRM revenue 2022 (US$m)	138	154	138
Faberge revenue 2020 (US$m)	7	9	8
Faberge revenue 2021 (US$m)	10	15	12
Faberge revenue 2022 (US$m)	15	20	16
Group revenue 2020 (US$m)	**62**	**102**	**53**
Cash mining and production costs 2020* (US$m)	(48)	(62)	(58)
Royalties 2020 (US$m)	(4)	(8)	(3)
Selling general and admin (US$m)	(45)	(49)	(45)
Change in inventory 2020 (US$m)	26	28	39
Group EBITDA 2020 (US$m)	**(10)**	**11**	**(14)**
PBT 2020 (US$m)	(38)	(16)	(41)
EPS 2020 (c)	(3)	(1.4)	(3)
Closing net cash (debt) US$m	**(11)**	**4**	**(21)**
Group revenue 2021 (US$m)	**212**	**241**	**218**
Group EBITDA 2021 (US$m)	**55**	**87**	**79**
PBT 2021 (US$m)	27	58	49
EPS 2021 (c)	(0)	2.0	2
Closing net cash (debt) 2021 US$m	**(1)**	**17**	**(15)**
Group revenue 2022 (US$m)	**243**	**273**	**244**
Group EBITDA 2022 (US$m)	**87**	**104**	**81**
PBT 2022 (US$m)	60	76	54
EPS 2022 (c)	2.0	2.8	1
Closing net cash/(debt) 2022 – US$m	**14**	**50**	**(3)**

Source: Edison Investment Research. Note: *Cash mining and production costs plus Faberge COGS. **As described in 28 April 2020 note.

Valuation

As previously, we value Gemfields using a discounted cash flow sum-of-the-parts model (at a 10% discount rate):

- Our updated sum-of-the-parts valuation totals US$349m or 23p per share (previously US$459m in our central case and US$339m in our slower recovery scenario).
- The rand per share valuation (of interest mostly to South African investors) is negatively affected by the stronger rand (ZAR16.51/US$ vs ZAR18.95/US$ previously) used to translate our predominantly US dollar driven valuation of Gemfields to rand per share.

Exhibit 2: Sum of the parts valuation

	New valuation	Previous – central case	Previous – slower recovery
Kagem (75%) – US$m	178	220	173
Montepuez (75%) – US$m	271	321	271
Fabergé – US$m	14	21	8
Sedibelo (6.54%) – US$m	40	40	40
Corporate overheads – US$m	(179)	(179)	(178)
Net cash – US$m (31 December 2019)	25	25	25
Sum of the parts valuation – US$m	**349**	**459**	**339**
Rand per share	4.93	7.44	5.50
Pence per share	23	31	23

Source: Edison Investment Research

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Exhibit 3: Financial summary

$m	2016	2017	2018	2019	2020e	2021e	2022e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT							
Revenue	0.0	81.7	206.1	216.2	62.1	212.4	242.6
Cost of Sales	0.0	(44.3)	(123.5)	(118.5)	(53.0)	(122.8)	(117.0)
Gross Profit	0.0	37.3	82.5	97.8	9.1	89.7	125.6
EBITDA	(5.9)	30.5	58.9	80.9	(10.2)	54.8	86.6
Operating Profit (before amort. and except.)	(5.9)	8.3	28.2	46.1	(36.1)	29.3	61.7
Fair value gains (losses)	50.4	49.5	(41.9)	14.3	0.0	0.0	0.0
Exceptionals	0.0	0.0	(22.6)	13.2	0.0	0.0	0.0
Share-based payments	0.0	(2.7)	(4.2)	(1.7)	(1.5)	(2.0)	(2.0)
Reported operating profit	44.5	55.1	(40.4)	71.9	(37.6)	27.3	59.7
Net Interest	0.0	(2.0)	(8.8)	(4.5)	(1.8)	(1.9)	(1.5)
Joint ventures & associates (post tax)	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Profit Before Tax (norm)	44.6	55.8	(22.5)	55.9	(38.0)	27.4	60.2
Profit Before Tax (reported)	44.6	53.1	(53.9)	67.4	(39.5)	25.4	58.2
Reported tax	(0.0)	(7.6)	(6.5)	(28.2)	4.1	(20.3)	(26.8)
Profit After Tax (norm)	44.6	48.2	(29.0)	27.6	(33.9)	7.1	33.4
Profit After Tax (reported)	44.6	45.5	(60.4)	39.1	(35.4)	5.1	31.4
Minority interests	0.0	(7.2)	(1.8)	(10.8)	2.5	(7.4)	(10.1)
Discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)	44.6	41.0	(30.8)	16.9	(31.4)	(0.3)	23.3
Net income (reported)	44.6	38.3	(62.2)	28.4	(32.9)	(2.3)	21.3
Average Shares Outstanding (m)	760	1,039	1,169	1,265	1,169	1,169	1,169
EPS - basic normalised (c)	586.1	3.9	(2.6)	1.3	(2.7)	(0.0)	2.0
EPS - normalised (c)	5.9	3.9	(2.6)	1.3	(2.7)	(0.0)	2.0
EPS - basic reported (c)	5.9	3.7	(5.3)	2.2	(2.8)	(0.2)	1.8
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Revenue growth (%)	NA!	NA	152.4	4.9	(-71.3)	242.3	14.2
Gross Margin (%)	NA!	45.7	40.1	45.2	14.7	42.2	51.8
EBITDA Margin (%)	NA	37.3	28.6	37.4	-16.4	25.8	35.7
Normalised Operating Margin	NA	10.2	13.7	21.3	-58.2	13.8	25.4
BALANCE SHEET							
Fixed Assets	359.7	639.6	509.7	507.4	495.5	497.8	506.7
Intangible Assets	0.0	49.3	52.3	55.2	55.2	55.2	55.2
Tangible Assets	0.0	378.0	365.0	376.9	360.9	363.3	372.1
Investments & other	359.7	212.2	92.4	75.3	79.4	79.4	79.4
Current Assets	7.4	184.1	224.4	276.8	207.4	224.9	245.2
Stocks	0.0	118.8	99.2	110.7	138.1	127.1	126.9
Debtors	1.2	27.5	62.1	87.8	37.0	55.9	61.8
Cash & cash equivalents	1.2	37.8	63.0	78.2	32.3	41.9	56.5
Other	5.0	0.0	0.0	0.0	0.0	0.0	0.0
Current Liabilities	(0.2)	(37.0)	(60.6)	(75.2)	(28.0)	(45.2)	(48.4)
Creditors	(0.2)	(21.2)	(28.2)	(29.9)	(10.1)	(21.2)	(22.4)
Tax payable	0.0	(7.0)	(1.4)	(17.4)	0.0	(6.1)	(8.0)
Short term borrowings	0.0	(4.2)	(23.2)	(24.8)	(14.8)	(14.8)	(14.8)
Other	0.0	(4.6)	(7.9)	(3.1)	(3.1)	(3.1)	(3.1)
Long Term Liabilities	0.0	(169.6)	(123.4)	(130.1)	(130.1)	(130.1)	(130.1)
Long term borrowings	0.0	(59.3)	(30.0)	(28.0)	(28.0)	(28.0)	(28.0)
Other long term liabilities	0.0	(110.3)	(93.4)	(102.1)	(102.1)	(102.1)	(102.1)
Net Assets	366.9	617.1	550.1	578.9	544.8	547.5	573.5
Minority interests	0.0	(78.4)	(73.9)	(84.7)	(82.1)	(85.1)	(87.8)
Shareholders' equity	366.9	538.7	476.2	494.3	462.7	462.4	485.7
CASH FLOW							
Op Cash Flow before WC and tax	(5.9)	30.5	58.9	80.9	(10.2)	54.8	86.6
Working capital	0.5	(9.7)	(29.7)	(25.7)	(13.7)	9.2	(2.5)
Exceptional & other	5.0	0.4	0.3	(8.8)	0.0	0.0	0.0
Tax	(0.0)	(7.6)	(24.4)	(9.7)	0.0	(20.3)	(26.8)
Net operating cash flow	(0.4)	13.6	5.1	36.7	(23.8)	43.7	57.3
Capex	0.0	(11.0)	(29.0)	(30.8)	(10.0)	(27.8)	(33.8)
Acquisitions/disposals	0.0	(17.9)	77.4	35.2	0.0	0.0	0.0
Net interest	0.0	(2.3)	(4.4)	(3.3)	(1.8)	(1.9)	(1.5)
Equity financing	0.0	(0.7)	(4.7)	(14.4)	(0.2)	0.0	0.0
Dividends	0.0	(5.0)	(5.9)	0.0	0.0	(4.4)	(7.4)
Other	0.0	(3.4)	(2.9)	(7.8)	0.0	0.0	0.0
Net Cash Flow	(0.4)	(26.6)	35.6	15.6	(35.9)	9.5	14.7
Opening net debt/(cash)	0.0	(1.2)	25.7	(9.8)	(25.4)	10.5	1.0
FX	0.0	(0.3)	(0.1)	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
Closing net debt/(cash)	(1.2)	25.7	(9.8)	(25.4)	10.5	1.0	(13.7)

Source: Company, Edison Investment Research

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