EDISON

Gemfields

COVID-19 update

Marching towards March 2021 auctions

Metals & mining

Although Gemfields has been unable to hold full gemstone auctions since February, successful November and December emerald mini-auctions generated US$10.8m in sales. Full in-person auctions are planned for March 2021 if travel restrictions lift by then. Gemfields has taken steps to preserve cash, including keeping both mines suspended, and we now forecast end 2020 net debt of US$11.6m (from US$10.5m previously).

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	7.4	N/A
12/20e	30.1	(94.2)	(5.9)	0.0	N/A	N/A
12/21e	183.5	1.8	(1.6)	0.0	N/A	N/A

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

Mini-auctions generated US$10.8m in sales

The series of five online emerald mini-auctions held in November and December generated US$10.8m in sales. Although not comparable to December 2019's full emerald auction revenues of US$27.2m, the success of this process does provide a positive indication of market demand and helps shore up the balance sheet, covering two months of cash costs with both mines suspended. If possible, Gemfields intends to hold one emerald and one ruby auction in March and thereafter we expect it to revert to holding three auctions every half year.

We now forecast December 2020 cash of US$47.8m

We have updated our forecasts to reflect the delay in auctions from late 2020 until March 2021 and the continued suspension of operations at both Kagem and MRM throughout 2020 and into early 2021. We now expect Gemfields to end 2020 with cash of US$47.8m (previously US$32.3m) after taking into account a new US$15m debt facility and we forecast net debt of US$11.6m (previously US$10.5m); the very minor change to our closing net debt forecast despite the significant change to our 2020 revenue forecast (to US$30.1m from US$62.1m previously) reflects the company's significant efforts to cut costs and changes to working capital forecasts. We now forecast an FY20 EBITDA loss of US$51.2m (previously US$10.2m) and FY21 EBITDA of US$29.2m (previously US$54.8m).

Valuation: Sum of the parts of US$320m or 21p/share

We value Gemfields on a discounted cash flow sum of the parts at a 10% discount rate. Our updated valuation is US$320m (21p or ZAR4.14 per share) compared to a previous valuation of US$349m (23p or ZAR4.93 per share). Where previously we forecast a US$13.7m working capital outflow in 2020, we now forecast a US$26.9m working capital inflow (lower production capitalised to inventory and lower closing auction receivables), which helps to cushion the blow of lower EBITDA from a cash flow and valuation perspective. While investors may rightly be aware of nearer-term funding risks if there is any further delay to when auctions can be held, we believe the significant long-term value is compelling.

16 December 2020

Price	**ZAR1.46**
Market cap	**ZAR1,707m**
	ZAR15.12/US$
Net debt (US$m) at 11 September 2020	3.2
Shares in issue	1,169m
Free float	72%
Code	GML/GEM.L
Primary exchange	Johannesburg
Secondary exchange	AIM

Share price performance

%	1m	3m	12m
Abs	13.3	15.1	(15.2)
Rel (local)	8.9	8.6	(19.1)
52-week high/low		ZAR2.12	ZAR1.10

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

Full year results	March 2021

Analysts

Alison Turner +44 (0)20 3077 5700

Charles Gibson +44 (0)20 3077 5724

mining@edisongroup.com

Edison profile page

Gemfields is a research client of Edison Investment Research Limited

Emerald mini-auctions total US$10.8m in sales

Gemfields ordinarily 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 emerald auctions (February and August, usually in Lusaka) and two mixed-quality ruby auctions (June and December, usually in Singapore). The practical challenge is that these auctions rely on customers travelling from multiple countries to carefully inspect the stones and determine the value of their bids, which has not been possible since February.

In response to this significant challenge and to fulfil customer demand for certain specific grades of emeralds, Gemfields held five mini-auctions in November and December where selected lots were made available for in-person and private viewings by customers in Tel Aviv, Singapore and Jaipur and then the auctions took place via a specially adapted online auction platform. In total, the five mini-auctions generated US$10.8m in sales, from the sale of 0.18Mcts.

While the average price achieved of US$59.84/ct was well below that of the December 2019 auction of US$85.26/ct, this reflects more the specific selection of stones offered for sale that any market weakness. All indications are that the mini-auctions attracted solid demand, with 47 companies placing bids and 86% of lots sold. Gemfields commented that 'prices remained robust and in a number of instances comfortably exceeded bids received in pre-COVID-19 auctions'.

Following the conclusion of the mini-auctions, Gemfields still holds sufficient high-quality emerald inventory to undertake a full-scale, high-quality auction in Q121, which is the company's intention, provided that travel restrictions lift sufficiently to allow it to take place.

Updated forecasts reflect auction delay to March 2021

For Gemfields to hold full-scale, in-person auctions requires the lifting of worldwide travel restrictions to the extent required to allow movement of both stones and customers between countries. In our August note (Cash preservation ahead of December auctions) we based our forecasts on the assumption that Gemfields would be able to hold 'near-normal' if slightly smaller HQ emerald and ruby auctions in December 2020. However, a second wave of COVID-19 in many countries including Europe and the US has meant international travel restrictions have not eased to the extent that would have been required for auctions to be held in Singapore this year and auctions are now planned by the company for March 2021. The company already holds sufficient gemstone inventory for these auctions and does not plan to resume mining operations until March 2021.

Exhibit 1 summarises our forecast key metrics updated to reflect the delay in gemstone auctions until March 2021 and the continued suspension of mining operations at both Kagem and Montepuez Ruby Mining (MRM) until March 2021. We also reflect the US$26.6m in write-downs taken at the H1 results.

We now expect Gemfields to end 2020 with cash of US$48m (previously US$32m) with our cash flow forecast assuming the drawdown of a further US$15m in asset-backed financing at MRM. We forecast closing 2020 net debt of US$12m (previously US$11m). The very minor change in 2020 net debt compared to our previous forecasts reflects the significant actions the company has taken to reduce costs, including the continued suspension of the mines. In addition, in our previous forecast around half of the then anticipated proceeds from the December auctions would have been received in cash in early 2021, hence the US$32m reduction in forecast FY20 revenue translates to a c US$16m reduction in cash proceeds received in 2020 and then this is largely offset by cost savings.

For FY21, we now forecast EBITDA of US$29m (US$55m previously) and expect Gemfields to end the year with net debt of US$11m (previously US$1m).

Exhibit 1: Forecast key metrics

	Previous	New
Kagem HQ emerald production 2020 (kcts)*	529	239
Kagem HQ emerald production 2021 (kcts)*	912	769
Kagem revenue 2020 (US$m)	28	23
Kagem revenue 2021 (US$m)	75	67
Kagem revenue 2022 (US$m)	90	90
MRM premium ruby production 2020 (kcts)	54	29
MRM premium ruby production 2021 (kcts)	103	74
MRM revenue 2020 (US$m)	27	0
MRM revenue 2021 (US$m)	128	107
MRM revenue 2022 (US$m)	138	138
Faberge revenue 2020 (US$m)	7	7
Faberge revenue 2021 (US$m)	10	10
Faberge revenue 2022 (US$m)	15	15
Group revenue 2020 (US$m)	**62**	**30**
Cash mining and production costs 2020 (US$m)**	(48)	(47)
Royalties (US$m)	(4)	(1)
Selling general and admin (US$m)	(45)	(37)
Change in inventory 2020 (US$m)	26	4
Group EBITDA 2020 (US$m)	(10)	(51)
PBT 2020 (US$m)	(38)	(108)
EPS 2020 (c)	(2.7)	(5.9)
Closing net cash (debt) 2020 (US$m)	**(11)**	**(12)**
Group revenue 2021 (US$m)	212	183
Group EBITDA 2021(US$m)	55	29
PBT 2021 (US$m)	27	2
EPS 2021 (c)	(0.0)	(1.6)
Closing net cash (debt) 2021 (US$m)	**(1)**	**(11)**
Group revenue 2022 (US$m)	243	243
Group EBITDA 2022 (US$m)	87	84
PBT 2022 (US$m)	60	58
EPS 2022 (c)	2.0	1.7
Closing net cash (debt) 2022 (US$m)	**13.7**	**(1.6)**

Source: Edison Investment Research. Notes: *Premium emeralds plus that portion of emeralds usually sent to HQ auctions. **Cash mining and production costs plus Faberge COGS.

Near-term funding headroom and debt facilities

Gemfields ended June 2020 still in a strong balance sheet position with US$9.3m in net cash. However, operating costs currently total US$5m a month and until meaningful auctions can be held this must be funded from the balance sheet. Investors may rightly be wary about pressure on Gemfields' balance sheet until there is more certainty around auction timing. However, our analysis suggests that if auctions can be held in March as planned, Gemfields has sufficient funding headroom. However, if auctions cannot be held in March (or within a few months thereafter), the company may need to seek additional funding. In particular, Gemfields explicitly states in its H1 results that in the absence of auction sales it would require further funding in Q321 in the form of additional bank lending, an asset sale programme of non-core assets and/or fund-raising through a potential rights issue.

Gemfields' debt facilities

The table below summarises Gemfields' debt facilities. At 30 June 2020 Gemfields had a total of US$44.4m in debt with a further US$15.6m in available undrawn facilities.

Exhibit 2: Gemfields debt and debt facilities (US$m) 30 June 2020

	Short term	Long term	Total drawn	Undrawn
ABSA Zambia (Kagem) US$20m term loan	2.0	18.0	20.0	
ABSA Mauritius US$10m Kagem revolver		10.0	10.0	
ABSA Mozambique (MRM) US$15m overdraft	4.5		4.5	10.5
BCI US$15m MRM overdraft	9.9		9.9	5.1
Total	**16.4**	**28.0**	**44.4**	**15.6**

Source: Gemfields interim results

Kagem has long-term debt facilities totalling US$30m (fully drawn as 30 June 2020) secured against the assets of Kagem:

- A fully drawn US$20m ABSA Zambia term loan fully repayable by 2024, which has a US$2m repayment due in December 2020.
- A fully drawn US$10m ABSA revolver repayable by 2022.

The Kagem facilities are subject to the following financial covenants:

- Senior debt service cover ratio shall not fall below 1.2x.
- Interest service cover ratio shall not fall below 2.5x.
- Senior net debt/EBITDA shall not exceed 2.5x.

Kagem has received a waiver of covenants.

In addition to the Kagem debt, at 30 June 2020 MRM had a total of US$30m in unsecured overdraft facilities of which US$15.6m was undrawn. These facilities are renewable annually with the ABSA Mozambique facility due for renewal shortly. Management expects these facilities to be renewed in the normal course of business.

In addition to its overdraft facilities, MRM is seeking to finalise a new US$15m financing lease facility. If secured, these facilities would provide further cash headroom at MRM until auctions can be held and operations resume in 2021.

Monthly cash flow forecasts

Gemfields ended June 2020 with cash of US$53.6m and net cash of US$9.3m, which had moved to a net debt position of US$3.2m as at 11 September 2020 (Gemfields H120 results).

In response to the COVID-19 pandemic and the inability of the company to hold rough emerald and ruby auctions, Gemfields has taken significant steps to manage its costs and cash burn and has reduced operating costs from 2019's monthly average of US$12.1m a month to under US$5m a month in June, including through the suspension of mining and processing at Kagem and MRM and all UK staff members including executive directors moving to a four-day working week for a 20% reduction in remuneration. The chart in Exhibit 3 illustrates our forecast Gemfields cash and net debt balances on a monthly basis through to the end of 2021, assuming that:

- Company-wide cash operating costs remain around US$5m a month until operations resume in March 2021, and rise to US$12m a month thereafter with the planned capital expenditure program of approximately US$5–7m a month also resuming in H221.
- US$10.8m is received from the completed online mini-auctions in November and December 2020, US$70m is received in March 2021 from one HQ emerald and one mixed-quality ruby auction, and a further US$10m in revenue is generated by June 2021 through online mini-auctions and/or holding a commercial quality emerald auction.

- The company received US$15m from a new MRM finance lease facility in late 2020 and makes a scheduled repayment of US$2m under the Kagem term loan in December 2020.
- Beyond June 2021, Gemfields returns to its usual auction schedule, generating a total of approximately US$90m in emerald and ruby auction revenue in August and November/December 2021.
- Our modelling does not assume any further drawdown on the undrawn US$15.6m in overdraft facilities available, so this headroom remains available in addition to the cash balance.

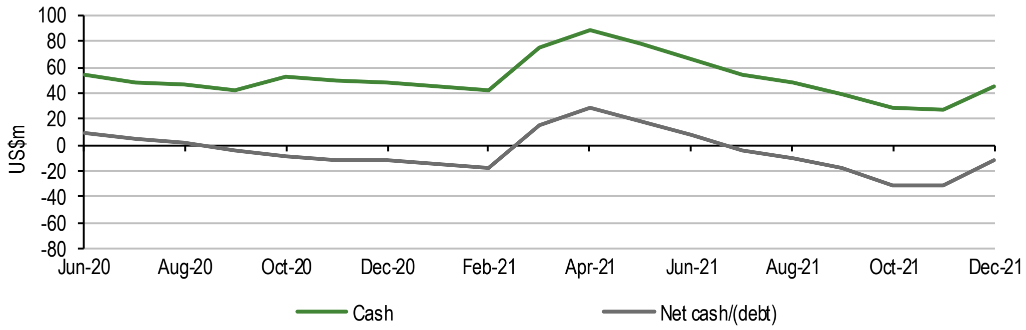
These assumptions and the closing 2020 and 2021 cash and net debt balances are in line with our annual profit and cash flow forecasts.

As the chart shows, our analysis suggests the company remains well placed to continue to meet its financial obligations through 2021, without the need for any further capital raising, provided that emerald and ruby auctions can be held as planned in March 2021 (or within a couple of months thereafter). Our analysis does not take into account potential proceeds from the planned sale of Gemfields' stake in Sedibelo Platinum.

However, even assuming that auctions take place as planned in March 2021, it may be that Gemfields will need to ask Kagem lenders to waive the June 2021 covenant test, or otherwise refinance that facility with alternative debt funding given that the lack of auctions in H220 will have a significant negative impact on rolling 12-month financial metrics.

We forecast year end 2020 cash of US$47.8m and net debt of US$11.6m. For December 2021 we forecast closing cash of US$46.4m and net debt of US$11.0m. H2 auctions being held earlier than usual in the year could positively affect working capital flows as our forecasts assume that US$30m in auction receivables will be outstanding at the end of December 2021.

Exhibit 3: Gemfields' monthly cash and net cash forecasts (US$m)



Source: Edison Investment Research

Sensitivities

We believe the two key risks facing Gemfields are the continued inability to hold emerald and ruby auctions while international travel restrictions remain in place (which if not resolved before March 2021 would put Gemfields under significant balance sheet pressure) and the escalating insurgent violence in northern Mozambique where Gemfields' MRM mine is located.

Delay to March auctions would put pressure on balance sheet

Our analysis shows Gemfields remains adequately funded with sufficient balance sheet headroom provided that normal in-person gemstone auctions can resume in March 2021, comprising one full HQ emerald and one mixed-quality ruby auction. However, as noted in Gemfields' H1 results, if auctions cannot take place as planned or fetch lower than expected revenues or lenders withdraw their support then the group may require additional funding and would seek to secure additional bank lending, pursue an asset sale programme of non-core assets and consider, should it become necessary, fund raising through a potential rights issue.

Heightened political and security risk in Mozambique

Since 2017, there has been a rise in insurgent attacks in Cabo Delgado 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 have escalated through 2020 and it is estimated that some 400,000 civilians have been displaced by the violence. While the Montepuez region itself has been less affected and Gemfields operations have not been directly affected, the growing security crisis in this region is a key risk for Gemfields.

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$320m or 21p per share (previously US$349m or 23p per share).
- The rand per-share valuation (of interest mostly to South African investors) is negatively affected by the impact of the stronger rand (15.12/US$ vs 16.51/US$ previously) on the translation of our US dollar-driven valuation of Gemfields to rand per share.

Exhibit 3: Sum-of-the-parts valuation

	New valuation	Previous
Kagem (75%) US$m	170	178
Montepuez (75%) US$m	249	271
Fabergé (100%) US$m	13	14
Sedibelo (6.54%) US$m	40	40
Corporate overheads US$m	(176)	(179)
Net cash US$m (31 December 2019)	25	25
Sum of the parts valuation US$m	**320**	**349**
Rand per share	4.14	4.93
Pence per share	21	23

Source: Edison Investment Research

Exhibit 4: Financial summary

$'m	2017	2018	2019	2020e	2021e	2022e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT						
Revenue	81.7	206.1	216.2	30.1	183.5	242.6
Cost of Sales	(44.3)	(123.5)	(118.5)	(70.6)	(122.9)	(120.5)
Gross Profit	37.3	82.5	97.8	(40.5)	60.6	122.1
EBITDA	30.5	58.9	80.9	(51.2)	29.2	84.1
Operating Profit (before amort. and except.)	8.3	28.2	46.1	(77.2)	4.3	60.2
Fair value gains (losses)	49.5	(41.9)	14.3	(12.5)	0.0	0.0
Exceptionals	0.0	(22.6)	13.2	0.0	0.0	0.0
Share-based payments	(2.7)	(4.2)	(1.7)	(1.5)	(2.0)	(2.0)
Reported operating profit	55.1	(40.4)	71.9	(91.2)	2.3	58.2
Net Interest	(2.0)	(8.8)	(4.5)	(4.5)	(2.5)	(2.4)
Joint ventures & associates (post tax)	0.0	0.0	0.0	0.0	0.0	0.0
Profit Before Tax (norm)	55.8	(22.5)	55.9	(94.2)	1.8	57.8
Profit Before Tax (reported)	53.1	(53.9)	67.4	(109.7)	(0.2)	55.8
Reported tax	(7.6)	(6.5)	(28.2)	15.1	(15.0)	(27.6)
Profit After Tax (norm)	48.2	(29.0)	27.6	(79.1)	(13.2)	30.2
Profit After Tax (reported)	45.5	(60.4)	39.1	(94.7)	(15.2)	28.2
Minority interests	(7.2)	(1.8)	(10.8)	10.0	(5.2)	(10.2)
Net income (normalised)	41.0	(30.8)	16.9	(69.1)	(18.4)	20.0
Net income (reported)	38.3	(62.2)	28.4	(84.7)	(20.4)	18.0
Average Shares Outstanding (m)	1,039	1,170	1,265	1,170	1,170	1,170
EPS - basic normalised (c)	3.9	(2.6)	1.3	(5.9)	(1.6)	1.7
EPS - normalised (c)	3.9	(2.6)	1.3	(5.9)	(1.6)	1.7
EPS - basic reported (c)	3.7	(5.3)	2.2	(7.2)	(1.7)	1.5
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0	0.0
Revenue growth (%)	nm	152.4	4.9	(-86.1)	509.3	32.2
Gross Margin (%)	45.7	40.1	45.2	-134.5	33.0	50.3
EBITDA Margin (%)	37.3	28.6	37.4	-169.9	15.9	34.7
Normalised Operating Margin	10.2	13.7	21.3	-256.2	2.4	24.8
BALANCE SHEET						
Fixed Assets	639.6	509.7	507.4	477.9	475.8	483.6
Intangible Assets	49.3	52.3	55.2	41.1	41.1	41.1
Tangible Assets	378.0	365.0	376.9	358.9	358.8	368.7
Investments & other	212.2	92.4	75.3	77.9	75.9	73.9
Current Assets	184.1	224.4	276.8	189.8	193.7	200.0
Stocks	118.8	99.2	110.7	118.0	96.8	92.1
Debtors	27.5	62.1	87.8	24.0	50.5	63.1
Cash & cash equivalents	37.8	63.0	78.2	47.8	46.4	44.7
Other	0.0	0.0	0.0	0.0	0.0	0.0
Current Liabilities	(37.0)	(60.6)	(75.2)	(52.1)	(73.1)	(72.6)
Creditors	(21.2)	(28.2)	(29.9)	(16.5)	(25.0)	(27.0)
Tax payable	(7.0)	(1.4)	(16.3)	0.0	(10.5)	(11.0)
Short term borrowings	(4.2)	(23.2)	(24.8)	(31.4)	(33.4)	(30.4)
Other	(4.6)	(7.9)	(4.2)	(4.2)	(4.2)	(4.2)
Long Term Liabilities	(169.6)	(123.4)	(130.1)	(130.1)	(126.1)	(118.1)
Long term borrowings	(59.3)	(30.0)	(28.0)	(28.0)	(24.0)	(16.0)
Other long term liabilities	(110.3)	(93.4)	(102.1)	(102.1)	(102.1)	(102.1)
Net Assets	617.1	550.1	578.9	485.5	470.3	493.0
Minority interests	(78.4)	(73.9)	(84.7)	(74.7)	(77.9)	(80.6)
Shareholders' equity	538.7	476.2	494.3	410.9	392.4	412.4
CASH FLOW						
Op Cash Flow before WC and tax	30.5	58.9	80.9	(51.2)	29.2	84.1
Working capital	(9.7)	(29.7)	(25.7)	26.9	13.7	(5.4)
Exceptional & other	0.4	0.3	(8.8)	0.0	0.0	0.0
Tax	(7.6)	(24.4)	(9.7)	0.0	(13.0)	(25.6)
Net operating cash flow	13.6	5.1	36.7	(24.3)	29.9	53.1
Capex	(11.0)	(29.0)	(30.8)	(8.0)	(24.8)	(33.8)
Acquisitions/disposals	(17.9)	77.4	35.2	0.0	0.0	0.0
Net interest	(2.3)	(4.4)	(3.3)	(4.5)	(2.5)	(2.4)
Equity financing	(0.7)	(4.7)	(14.4)	(0.2)	0.0	0.0
Dividends	(5.0)	(5.9)	0.0	0.0	(2.0)	(7.5)
Other	(3.4)	(2.9)	(7.8)	0.0	0.0	0.0
Net Cash Flow	(26.6)	35.6	15.6	(37.0)	0.6	9.4
Opening net debt/(cash)	(1.2)	25.7	(9.8)	(25.4)	11.6	11.0
FX	(0.3)	(0.1)	0.0	0.0	0.0	0.0
Other non-cash movements	0.0	0.0	0.0	0.0	0.0	0.0
Closing net debt/(cash)	25.7	(9.8)	(25.4)	11.6	11.0	1.6

Source: Company, Edison Investment Research

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
1185 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