# Golden Prospect Precious Metals

## Focusing on higher-quality producing assets

Investment companies

**While gold and silver price weakness has had an unfavourable effect on Golden Prospect Precious Metals' (GPM) recent performance, the managers see a number of positive indicators for gold and silver markets and have increased the exposure to operating companies in the portfolio during 2014. A focus on investing in companies with higher-quality producing assets operating at the lower end of the cost curve provides a level of downside protection. Silver exposure has been increased to benefit from a potential rise in industrial demand.**

| 12 months ending | Total share price return (%) | Total NAV return (%) | Philadelphia Gold & Silver (%) | Market Vectors Junior Gold Miners (%) | NYSE Arca Gold Bugs (%) |
|---|---|---|---|---|---|
| 31/10/11 | 41.4 | 18.7 | (0.7) | (6.1) | 8.5 |
| 31/10/12 | (19.2) | (9.6) | (4.9) | (18.2) | (9.3) |
| 31/10/13 | (58.9) | (52.5) | (48.1) | (58.4) | (52.1) |
| 31/10/14 | (24.3) | (34.0) | (30.6) | (33.6) | (32.9) |

Note: Twelve-month rolling discrete total return performance; indices £-adjusted.

### Investment strategy: Focus on asset quality

GPM aims to generate above-average returns mainly through investing in the precious metals sector. Stock selection is primarily based on bottom-up analysis focusing on the quality of underlying assets and the sensitivity of valuations to changes in metals prices. This is supported by a top-down assessment of precious metals market fundamentals. The portfolio maintains a small-/mid-cap bias with a focus on gold and silver producing companies rather than earlier-stage explorers and developers that have a higher risk profile. The managers focus on investing in companies with higher-quality producing assets able to remain profitable at lower metals prices, which provides a measure of downside protection. They are broadly positive on the outlook for gold and silver prices and during 2014 have been positioning the portfolio towards holdings that are more geared to metal prices.

### Outlook: Positive indicators

Recent signs of increasing Indian and Chinese gold demand and the stabilisation of ETF holdings in 2014 after a sharp decline in 2013 give grounds for a more positive view of the gold market. Consumer demand is likely to be the main driver for the gold market, while silver should also benefit from rising industrial demand. Uncertainties over US interest rate rises and concerns over European and Chinese economic slowdowns seem likely to continue in the near term and create an environment in which volatility could persist.

### Valuation: Recent narrowing of discount

GPM's share price discount to NAV (including income) contracted from a 12-month high of 19% in mid-July 2014 to below 10% at the end of October 2014, as the share price proved less sensitive to the gold price than the NAV. The discount currently stands at 8.5%, which is similar to its 8.3% three-year average.

**7 November 2014**

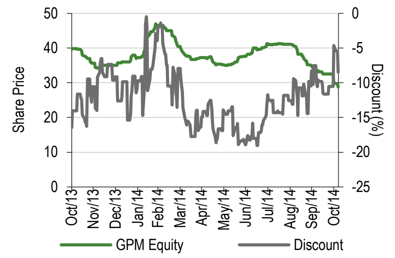
| | |
|---|---|
| **Price** | **28.8p** |
| **Market cap** | **£16.4m** |
| **NAV*** | **£17.9m** |

| | |
|---|---|
| NAV* | 31.5p |
| Discount to NAV | 8.5% |
| Yield | 0.0% |

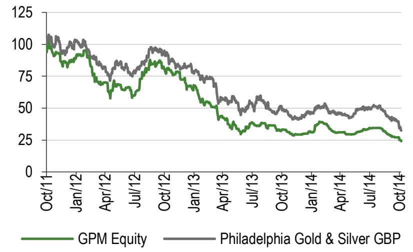
*Including income as at 31 October 2014.

| | |
|---|---|
| Ordinary shares in issue | 57.0m |
| Code | GPM |
| Primary exchange | LSE (SETS QX) |
| Secondary exchange | Channel Islands SX |
| AIC sector | SS: Commodities & Natural Resources |

#### Share price/discount performance*




#### Three-year cumulative perf. graph




| | | |
|---|---|---|
| 52-week high/low | 47.0p | 28.8p |
| NAV* high/low | 50.3p | 31.5p |

*Including income.

#### Gearing

| | |
|---|---|
| Gross | N/A |
| Net | 13.4% |

#### Analysts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Edison profile page

***Golden Prospect Precious Metals Limited is a research client of Edison Investment Research Limited***

## Exhibit 1: Company at a glance

**Investment objective and fund background**

Golden Prospect Precious Metals' investment objective is to generate above-average returns for shareholders, primarily through the capital appreciation of its investments. GPM invests selectively in a portfolio of securities and other instruments in the precious metals, diamond and uranium sectors. These include, but are not limited to, shares, convertibles, fixed-income securities and warrants, as well as physical commodities.

**Recent developments**

8 October 2014: H114 results – NAV total return +20.5%, index +16.8%, gold price +5.8%.
4 April 2014: FY13 final results – NAV total return -55.1%, index -49.0%, gold price -29.4%.

**Forthcoming**

| | |
|---|---|
| AGM | May 2015 |
| Preliminary results | April 2015 |
| Year end | 31 December |
| Dividend paid | N/A |
| Launch date | 28 November 2006 |
| Continuation Vote | N/A |

**Capital structure**

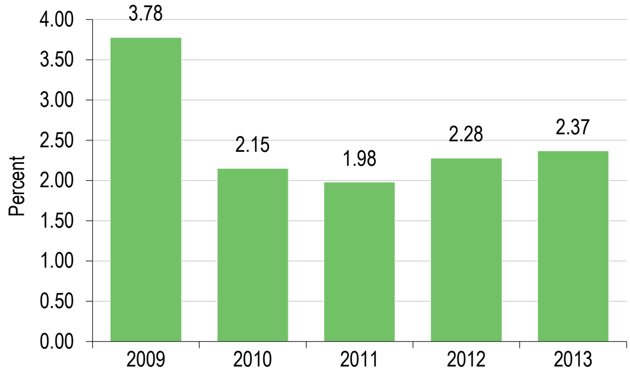
| | |
|---|---|
| Ongoing charges | 2.37% |
| Net gearing | 13.4% |
| Annual mgmt fee | 1.25% of net assets |
| Performance fee | 20% of net assets above 8% hurdle |
| Trust life | Indefinite |
| Borrowing facilities | See page 7 |

**Fund details**

| | |
|---|---|
| Group | New City Investment Managers |
| Managers | Will Smith, Keith Watson |
| Address | 5th Floor, 33 Chester Street, London SW1X 7BL |
| Phone | +44 (0)20 7201 6900 |
| Website | www.ncim.co.uk |

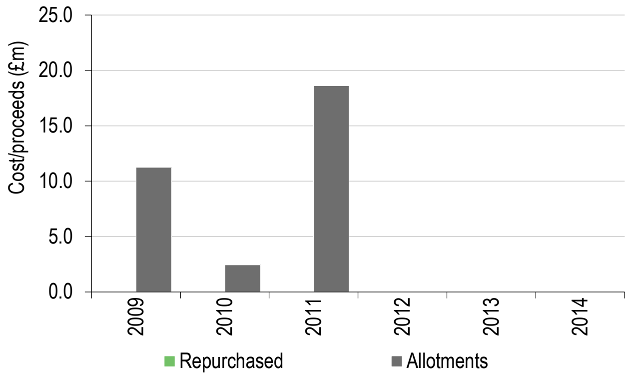
**Ongoing charge history**

From 1 January 2014, the management fee has been reduced from 1.50% to 1.25% pa. No performance fee has been paid since 2007.

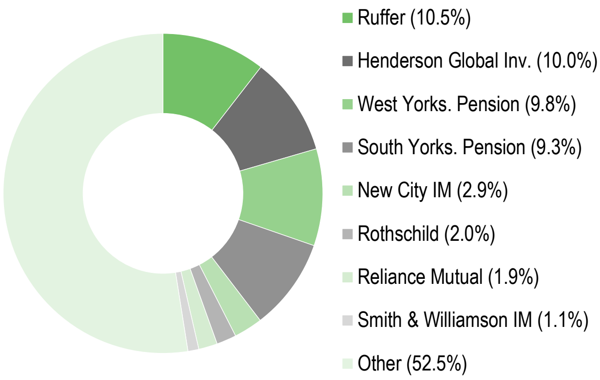



**Share buyback policy and history**

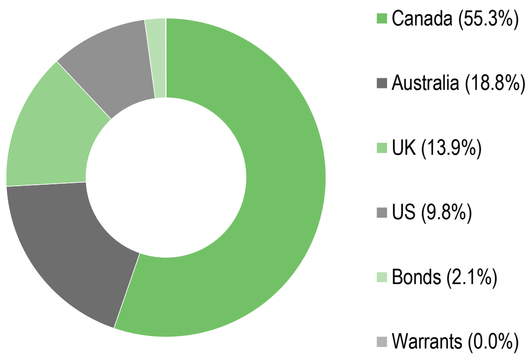
Renewed annually, the company has authority to purchase up to 14.99% of the issued share capital and re-issue shares from treasury.




**Shareholder structure (as at 15 October 2014)**




**Distribution of portfolio by listing (as at 30 June 2014)**




**Top 10 holdings (as at 30 September 2014)**

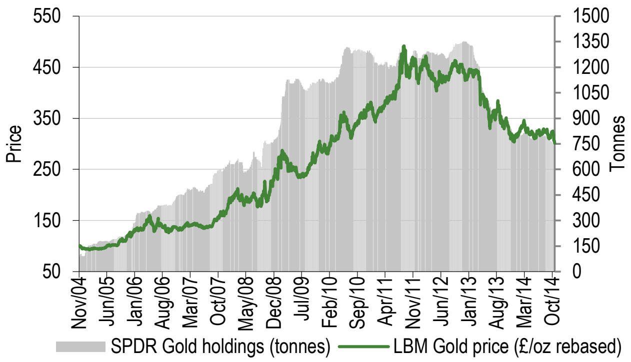
| Company | Country of listing | Commodity | Development stage | % of total net assets 30 Sept 2014 | % of total net assets 30 Sept 2013* |
|---|---|---|---|---|---|
| Fresnillo | UK | Silver | Producer | 7.1 | 5.2 |
| Beadell Resources | Australia | Gold | Producer | 7.0 | N/A |
| Fortuna Silver Mines | Canada | Silver | Producer | 6.5 | N/A |
| First Majestic Silver | Canada | Silver | Producer | 6.2 | 7.2 |
| Mandalay Resources | Canada | Silver / Gold | Producer | 5.1 | N/A |
| ETFS Physical Palladium | UK | PGMs | Bullion | 4.5 | N/A |
| Silver Wheaton | Canada | Silver | Producer | 4.4 | 13.8 |
| Resolute Mining | Australia | Gold | Producer | 4.0 | 5.1 |
| Mountain Province | US | Diamonds | Developer | 4.0 | N/A |
| Continental Gold | US | Gold | Explorer | 3.8 | N/A |
| **Top 10** | | | | **52.6** | **N/A** |

Source: Golden Prospect Precious Metals, Edison Investment Research, Morningstar, Thomson Reuters. Note: *N/A where not in September 2013 top 10.

## Market outlook: Positive indicators

Having fallen by close to 30% in sterling terms in 2013, the gold price has remained relatively stable during 2014 and at the end of October stood 1% higher than at the start of the year despite its recent weakness. ETF holdings of physical gold, considered by GPM's portfolio managers to be a good reflection of investment demand, have also remained relatively stable, as reflected by the SPDR Gold ETF's holdings declining 7% during the first 10 months of 2014 compared with the 41% decrease during 2013 (illustrated in Exhibit 2). During the first 10 months of 2014, the silver price declined by 14% in sterling terms, following its 36% fall in 2013. A major component of industrial silver demand is the production of photovoltaic cells. Excess inventories of finished cells in China, which have weighed on demand, are now widely believed to have been depleted and industry associations anticipate increasing renewable energy demand may drive demand growth from 2014.

**Exhibit 2: LBM gold price (£/oz rebased) vs SPDR Gold ETF holdings (tonnes)**




Source: SPDR Gold, Datastream, Edison Investment Research

**Exhibit 3: Gold:silver and platinum:gold price ratios over 10 years**


Source: Bloomberg, Edison Investment Research

Illustrated in Exhibit 3, the gold:silver price ratio has followed an upward trend since May 2011 and the current ratio of over 70x has not been sustained for more than six months during the last 10 years. While not a fundamental driver, the expectation for reversion of the gold:silver price ratio towards its 58x 10-year average could positively influence investment demand. Exhibit 3 also illustrates that the platinum:gold price ratio is currently close to parity, which could be considered a positive indicator for the platinum price. However, industrial demand for platinum is driven by the European auto-catalyst market and the recent weakening of the economic growth outlook in Europe is likely to temper any expectations for increases in industrial demand.

Indian and Chinese consumer demand account for around 40% of global gold demand and recent signs of increasing demand in both countries support a positive outlook. Indian gold imports rose sharply in the third quarter following the recent easing of import restrictions and the Shanghai Gold Exchange reported an increase in withdrawals during September and October. Macroeconomic factors can have a significant influence on gold market sentiment and uncertainties over the timing and pace of US interest rate rises, together with concerns over economic growth in Europe and China, create an environment in which gold price volatility could persist.

## Fund profile: Gold and precious metals specialist

Golden Prospect Precious Metals Limited (GPM) was incorporated in Guernsey in 2006 as a limited liability closed-end investment company. Its investment objective is to generate above-average returns primarily through capital appreciation by investing in a relatively focused portfolio of securities and other instruments in the precious metals, diamond and uranium sectors. The fund has no specific benchmark index and the manager has an absolute return target. Performance is compared with the Philadelphia Gold & Silver Index (PHLX Gold/Silver) and the Market Vectors Gold and Junior Gold Miners ETFs (GDX and GDXJ). New City Investment Managers (NCIM) has managed the fund since its appointment in September 2008. Will Smith has acted as GPM's portfolio manager since July 2013, following the departure of John Wong, and Keith Watson was appointed joint portfolio manager in January 2014. The portfolio managers are supported by the other members of the NCIM team.

## The fund managers: Will Smith, Keith Watson

### The managers' view: Focus on quality of underlying assets

During 2014, the managers have been rotating the portfolio out of ETF holdings, which are selectively used to provide direct exposure to precious metals prices, into operating companies providing a more geared exposure. The fundamental investment focus has been the quality of the underlying assets, which is reflected in the indicative all-in sustaining costs of the producing companies held in the portfolio. The manager reports that, based on company guidance and consensus estimates, over 90% of the gold producers are profitable in 2014 at a gold price of US$1,100/oz, and in 2015 over 85% are profitable. On the same basis, over 70% of the silver producers are profitable in 2014 at a silver price of US$15/oz and in 2015 over 65% are profitable. At the time of writing, the gold price stands at US$1,145/oz and silver US$15.4/oz.

While the increase in exposure to producing companies raises the portfolio's gearing to gold and silver prices, there is a degree of downside protection provided by investing in lower-cost producers that can sustain production at lower metal prices. The managers note that the highest risk profile is presented by development-stage companies where valuations can be significantly affected by capital cost inflation and project delays, in addition to fluctuating metal prices. Investment is still considered in exploration companies, which the managers believe have higher-quality potential projects with high-grade ore and low strip ratios, Condor Gold being an example currently held in the portfolio.

Top five holdings Beadell Resources and Fortuna Silver provide good examples of characteristics preferred by the managers when selecting stocks. Beadell Resources is an Australia-listed gold producer with operations in Brazil. The managers believe the stock has been unfairly de-rated due to some short-term operational issues that were not well communicated to the market and think that the shares are currently trading at attractive levels compared with Beadell's DCF-based NAV at a gold price of US$1,200/oz. Fortuna Silver is a Canada-listed silver producer with operations in Peru and Mexico. Fortuna is considered by the managers to be a well-managed business capable of delivering substantial production growth at its low-cost operations. Despite taking some profits as the share price ran ahead of metal prices earlier in the year, the managers remain favourably disposed to the silver mining sector.

The managers see a number of incrementally positive fundamental developments across the precious metals markets including a relaxation of Indian gold import controls and declines in oil and steel prices, which can significantly affect the operating and capital costs of mining projects. They currently have a relative preference for silver, citing the potential benefit of improving global industrial demand, the speculative silver futures short position being close to an all-time high and the historically high gold:silver ratio.

The managers consider that recent falls in commodity prices point to deflation and therefore increase the likelihood of further financial stimulus, particularly in Europe and China, which has the potential to increase demand for commodities. While the current low platinum:gold ratio could be seen as a positive indicator for the platinum price, within platinum group metals (PGMs) the managers retain a preference for palladium, which has the potential to benefit from a restriction on Russian exports. South African platinum industry fundamentals are considered to be unfavourable for platinum mining companies and the fund's platinum exposure is maintained through ETFs.

# Asset allocation

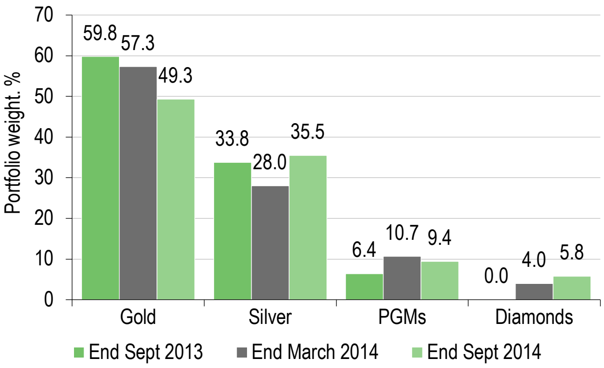
## Investment process: Bottom-up with top-down overlay

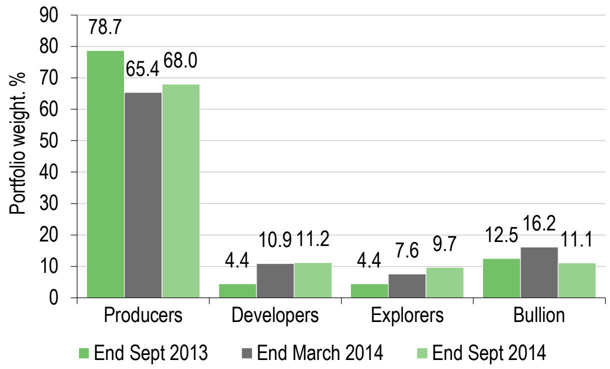
GPM's investment process is primarily based on bottom-up stock selection supported by a top-down overlay. An assessment of the macroeconomic environment through fundamental research and interaction with CQS trading teams identifies broader themes that are taken into consideration in the stock selection process, including geopolitical concerns, currency trends, market liquidity and sentiment. Additionally, sector analysis is undertaken addressing global demand factors to establish a specific precious metal asset allocation overlay. Stock selection is performed by an experienced team with extensive industry knowledge and is based on management meetings and detailed valuation analysis. A range of valuation metrics, including DCF analysis, are used to identify undervalued assets and valuations are stress-tested at a range of commodity price forecasts.

## Portfolio positioning

At 30 September 2014 the portfolio had 46 holdings compared to 52 at end March 2014 and 41 at end September 2013. The decline in holdings over the last six months principally reflects the sale of ETF holdings, with the proceeds used to increase positions in existing holdings. Portfolio concentration in the top five holdings was 32.6% at end September 2014, higher than end March 2014 (27.6%), but significantly lower than end September 2013 (45.0%). As illustrated in Exhibit 4, GPM's exposure to gold has declined to below 50% of the portfolio over the 12 months to 30 September 2014, while exposures to silver, PGMs and diamonds have all increased. Since end March 2014 there has been an 8.0 percentage point decrease in gold exposure, almost matched by a 7.5 point increase in silver exposure.

**Exhibit 4: Portfolio analysis by commodity and company development stage**




Source: Golden Prospect Precious Metals, Edison Investment Research

Exhibit 4 also illustrates the portfolio's exposure to companies at different stages of development and clearly highlights the managers' preference for producing companies over developers and explorers. There has been a 10 point decrease in the weighting of producers since end September 2013, although exposure has modestly increased since November 2013, while direct exposure to bullion through ETFs has been reduced. The addition of diamonds exposure during the last 12 months has contributed to an increase in the portfolio weighting of developers and explorers. As illustrated in Exhibit 1, GPM is primarily invested in Canada- and Australia-listed equities.

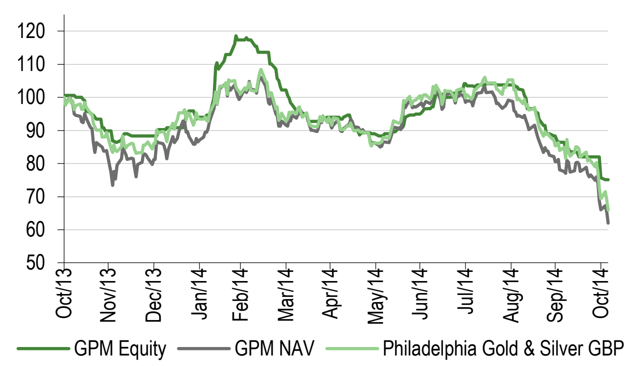
# Performance: Outperformance over five years

As illustrated in Exhibit 6, GPM's share price and NAV total return have underperformed PHLX Gold/Silver over one and three years and since inception, while outperforming over five years. GPM's relative performance, shown in Exhibit 5, should be considered in the context of a decline in gold and silver equities and GPM's use of gearing. While it has underperformed the broader PHLX

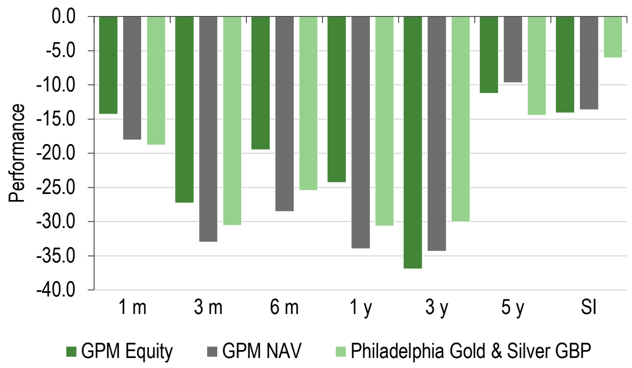
Gold/Silver over most periods, GPM has achieved a positive three- and five-year performance relative to the Market Vectors Junior Gold Miners Index, which captures the underperformance of small-cap precious metals equities, where GPM has tended to have a greater exposure. Exhibit 7 illustrates GPM's strong relative performance from October 2009 to July 2011, a period of strength in the gold price. While GPM has underperformed PHLX Gold/Silver since July 2011, a large proportion of the prior outperformance has been retained. Since the start of 2014, GPM's performance has been similar to the index.

**Exhibit 5: Investment company performance to 31 October 2014**

**Price, NAV and index total return performance, one-year rebased**




**Price, NAV and index total return performance (%)**



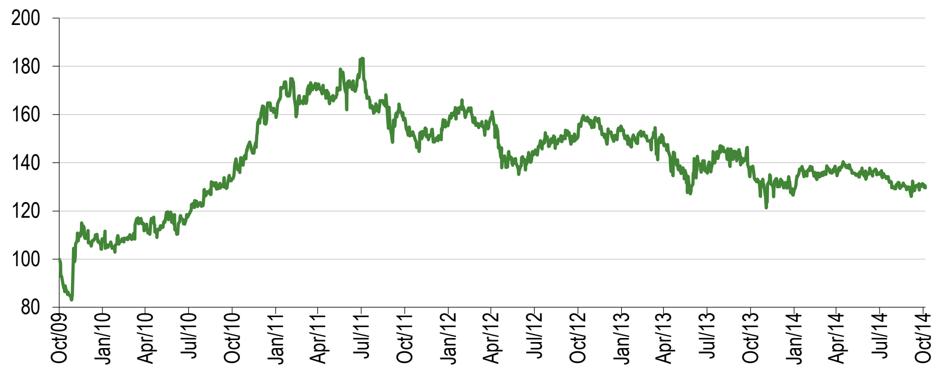

Source: Golden Prospect Precious Metals, Thomson Datastream, Edison Investment Research. Note: Three and five years and since inception (SI) annualised.

**Exhibit 6: Share price and NAV total return performance, difference versus indices (percentage points)**

| | 1 month | 3 months | 6 months | 1 year | 3 y | 5 y | SI |
|---|---|---|---|---|---|---|---|
| Price versus Philadelphia Gold & Silver | 4.5 | 3.3 | 6.0 | 6.4 | (9.2) | 9.2 | (31.1) |
| NAV versus Philadelphia Gold & Silver | 0.7 | (2.4) | (3.1) | (3.3) | (5.9) | 14.3 | (29.8) |
| Price versus Market Vectors Junior Gold Miners | 10.3 | 9.1 | 7.6 | 9.3 | 2.5 | 18.3 | (10.0) |
| NAV versus Market Vectors Junior Gold Miners | 6.5 | 3.4 | (1.5) | (0.4) | 5.7 | 23.4 | (8.7) |
| Price versus NYSE ARCA Gold Bugs | 4.6 | 2.0 | 7.1 | 8.6 | (4.1) | 11.4 | (30.2) |
| NAV versus NYSE ARCA Gold Bugs | 0.9 | (3.7) | (1.9) | (1.1) | (0.8) | 16.5 | (28.9) |

Source: Golden Prospect Precious Metals, Thomson Datastream, Edison Investment Research. Note: Since inception (SI) represents the period since 27 November 2006.

**Exhibit 7: NAV total return performance relative to index over five years**

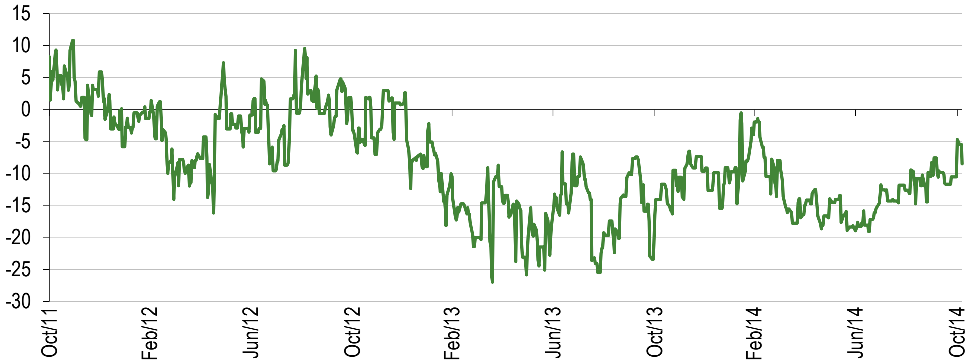



Source: Thomson Datastream, Edison Investment Research

## Discount: Recent narrowing

Between September 2011 and June 2013 the gold price fell by over 35% and, over the same period, GPM's share price discount to NAV (including income) widened from 5% to 21%. More recently, the share price has proved less sensitive to the gold price than the NAV, with the discount contracting from a 12-month high of 19% to below 10% at the end of October 2014, coinciding with an 11% decline in the gold price. The current discount stands at 8.5%, which is similar to its three-year average of 8.3%.

**Exhibit 8: Share price premium/discount to NAV (including income) over three years**




Source: Thomson Datastream, Edison Investment Research

## Capital structure and fees

GPM has 57.0m ordinary shares and 28.5m subscription shares in issue. The company is authorised to purchase up to 14.99% of the issued share capital. No purchases or issues of shares have been made since October 2011 other than marginal issuance of shares on the exercise of subscription shares (issued in November 2011). The subscription shares confer the right to subscribe for ordinary shares at 130p and, if unexercised, the rights will lapse in November 2014.

The current debt to equity ratio is expected to be maintained within 30% of NAV, although in practice the managers aim to restrict gearing to 20%. Gearing increased sharply from 1.2% at end February 2014 to 19.5% at end March 2014 as the manager increased holdings in equities such as Fortuna Silver, which had experienced appreciable share price declines. Subsequently, gearing has been reduced to c 10% as holdings in ETFs have been sold down. An overdraft facility is provided by Credit Suisse charged at one-month Libor plus 175bp.

With effect from 1 January 2014, GPM reduced the annual management fee paid to NCIM from 1.5% to 1.25% of NAV. NCIM is also entitled to an annual performance fee equal to 20% of the increase in NAV above a hurdle of 8% and subject to a high-water mark. For FY13, the management fee was £0.5m, no performance fee was payable and ongoing charges were 2.37%.

## Dividend policy

The directors do not expect the portfolio to generate significant income (net of expenses) and consequently do not expect to declare any cash dividends. In the event that net income becomes significant, the directors may consider making dividend distributions. GPM has not paid any dividends since launch in 2006.

## Peer group comparison

Exhibit 9 shows a closed-ended peer group across the commodities and natural resources sector and an open-ended peer group focusing primarily on gold. GPM's NAV total return is at the lower end of the closed-ended peer group over one, three and five years, while in comparison with the open-ended peer group averages it is modestly higher over one and three years and significantly ahead over five years. This differentiated performance relative to each peer group reflects GPM's particular focus on gold and the divergence between gold and the overall commodities and natural resources sector. In terms of risk-adjusted returns, GPM has Sharpe ratios below one over one and three years similar to the closed-ended peer group averages. GPM's FY13 ongoing charge of 2.37% is above the closed-ended and open-ended peer group averages, although comparable to similar-sized closed-ended funds. The board has taken steps to reduce the ongoing charge and, as noted, from 1 January 2014, the management fee has been reduced from 1.50% to 1.25% pa.

**Exhibit 9: Open and closed-ended funds investing in gold and resources equities (as at 5 November 2014)**

| % unless stated | Market cap/ fund size £m | NAV TR 1 Year | NAV TR 3 Year | NAV TR 5 Year | Sharpe 1y (NAV) | Sharpe 3y (NAV) | Discount (ex par) | Ongoing charge | Perf fee | Net gearing |
|---|---|---|---|---|---|---|---|---|---|---|
| Golden Prospect Precious Metals | 17.0 | (24.9) | (69.6) | (37.5) | (0.5) | (0.7) | (13.0) | 2.37 | Yes | 101 |
| Altus Resource Capital | 26.8 | (21.6) | (67.4) | (48.2) | (0.5) | (0.9) | 6.4 | 2.47 | Yes | 94 |
| Baker Steel Resources | 17.4 | (27.6) | (53.7) | | (1.9) | (1.1) | (46.2) | 2.17 | Yes | 100 |
| BlackRock Commodities Income | 110.6 | (12.3) | (17.3) | 1.9 | 0.2 | 0.1 | 5.1 | 1.39 | No | 107 |
| BlackRock World Mining Trust | 615.2 | (28.0) | (48.7) | (31.6) | (0.6) | (0.5) | (6.1) | 1.37 | No | 118 |
| City Natural Resources | 84.3 | (11.3) | (53.6) | (25.3) | (0.3) | (0.9) | (8.1) | 1.70 | No | 128 |
| El Oro | 45.1 | (3.7) | (23.7) | 3.9 | (0.6) | (0.5) | (23.5) | 2.23 | Yes | 149 |
| **Average** | **130.9** | **(18.5)** | **(47.7)** | **(22.8)** | **(0.6)** | **(0.6)** | **(12.2)** | **1.96** | | **114** |
| **Mutual funds** | | | | | | | | | | |
| BlackRock Gold & General | 842.5 | (20.3) | (62.0) | (48.5) | | | | 1.92 | | |
| Investec Global Gold | 35.4 | (24.7) | (62.3) | (46.9) | | | | 1.62 | | |
| MFM Junior Gold | 8.6 | (26.6) | (82.6) | (77.1) | | | | 1.79 | | |
| Ruffer CF Baker Steel Gold | 132.8 | (29.3) | (74.6) | (67.9) | | | | 1.95 | | |
| Smith & Williamson Global Gold & Resources | 33.0 | (18.4) | (62.3) | (43.0) | | | | 1.81 | | |
| Way Charteris Gold & Precious Metals Portfolio | 4.1 | (30.8) | (76.5) | | | | | 2.23 | | |
| SF Webb Capital Smaller Companies Gold | 1.6 | (36.7) | (79.8) | (70.3) | | | | 3.53 | | |
| **Average** | **151.1** | **(26.7)** | **(71.4)** | **(59.0)** | | | | **2.12** | | |

Source: Morningstar, Datastream, FE Trustnet, Edison Investment Research. Note: TR=total return. Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar for 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by annualised standard deviation. Net gearing is total assets less cash/cash equivalents as a percentage of shareholders' funds.

## The board

The board comprises four non-executive directors, all of whom are considered independent of the investment manager. Chairman Malcolm Burne founded Golden Prospect and was its executive chairman until 2007 when it became Ambrian Capital. Ambrian Capital was GPM's investment manager from launch until NCIM's appointment in September 2008. Kaare Foy was a director of Great Panther Silver from 1994 until 2012 and is chairman of Viscount Mining, Polar Star Mining and Cangold. Robert King has worked in the offshore fund administration industry since 1986 and is a director of a number of investment companies based in Guernsey. Toby Birch is a director of a number of investment funds and companies, and was previously investment manager of the Blackfish Capital Exodus Fund, trading in commodities, precious metals and real asset themes. Toby Birch joined the board in April 2014 while the other three directors were appointed at GPM's launch in November 2006. Paul Craig and John Bowles resigned from the board in April 2014.



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