



# HALLGARTEN & COMPANY

## Corporate Actions

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## Galane Gold (TSX-V: GG) Strategy: SHORT

<b>Key Metrics</b>					
Price (CAD)	\$	0.075			
12-Month Target Price (CAD)	\$	0.030			
Upside to Target		-60%			
High-low (12 mth)		\$0.06 - \$0.215			
Market Cap (CAD mn)	\$	4.09			
Shares Outstanding (millions)		54.5			
		<b>2013</b>	<b>2014e</b>	<b>2015e</b>	<b>2016e</b>
Consensus EPS			n/a	n/a	n/a
Hallgarten EPS (est.)			\$0.034	(\$0.097)	(\$0.013)
Actual EPS		(\$0.57)			
P/E		n/a	2.18	n/a	n/a

# Galane Gold

## Reputational Risk

- + The company has managed to persuade Samsung and the Botswanan government to accept delayed payment terms due to the company's financial problems
- + The company has around five years of LOM ahead of it from various exploitable deposits on its existing tenements
- ✘ The gold price is the chief vulnerability of the company with a further leg down restricting the ability to profitability exploit some of its future prospects
- ✘ Earnings have slumped into a loss with the company running gross losses in some quarters of this year
- ✘ Production is down heavily from the average of previous years
- ✘ Beyond the assets the company currently holds there is almost nothing in the general vicinity that would make sense as a bolt-on to the production schedule
- ✘ This has resulted in a move into South Africa which is not being well-viewed
- ✘ Debt taken on in this deal is doubles the company's liabilities
- ✘ Samsung will be warier of doing deals with gold producers after this unfortunate first transaction
- ✘ A move to London may be haunted by the exploits of other companies in the corporate grouping

### **Cobbling Together an African Gold "Empire"**

Our oft-repeated mantra is that "Production is King", however if the production is chronically unprofitable then no amount of production will satisfy regal aspirations.

Galane Gold, when we last wrote about it, was an un-hedged gold producer and explorer with mining operations and exploration tenements in Botswana. It has an array of small mines that function with a centrally placed mill. Many of these mines have historical antecedents, but in the latest iteration the "complex" has been operating for most of the last decade, firstly under Gallery Gold, then IAMgold and latterly Galane Gold.

The company's shares are quoted on the TSX Venture Exchange and the Botswana Stock Exchange under the symbol GG. It acquired the Mupane complex from IAMgold in the second half of 2011.

The main part of the company's asset base is the Mupane concessions, which have their roots in the historic Monarch mine, from which activity spread forth across the whole of the Tati Greenstone Belt.

Despite a veteran team of skilled operators, things have not been going well in 2015 with spiraling

losses, a forced renegotiation of offtake and royalty deals and now an entry into South African gold mining. We shall review here the negative evolution of circumstances.

### **The Samsung Deal**

What looked like a good deal with Samsung has now turned into a nightmare....for Samsung. It is relevant to revisit the deal of last year with Samsung as current production volumes are similar to the amount that the Korean company has the exclusive option to purchase.

Galane Gold unveiled in late August that it had entered into a secured US\$5mn loan facility and gold prepayment agreement with Samsung C&T U.K. Limited. The loan facility was in return for the sale and delivery of a minimum of 1,607 ounces of gold per month for a period of two years (38,568 ounces in aggregate) payable by Samsung at a fixed discount rate to the then prevailing spot price upon delivery.

Samsung also has an exclusive option to purchase all gold produced by Mupane above 1,607 ounces per month on a non-discounted basis at the then prevailing spot price for the two-year period. The loan facility is repayable by Galane over the two year period by way of 18 equal principal payments commencing seven months after the initial advancement of the facility. The facility is secured first by a pledge of the shares of Mupane and then replaced with a first charge against the assets of Mupane.

In early November 2015, Galane announced that it had renegotiated the repayment terms of the loan facility and gold prepayment arrangement provided by Samsung. This was essentially a temporary waiver to save Galane from being in default.

The Samsung facility has been amended on the following terms:

- the current schedule of 10 remaining monthly instalments of \$277,000 and one monthly instalment of \$291,000 has been amended to a repayment of 12 instalments of \$20,000 per month effective from October 2015, followed by 9 instalments of \$277,000 and a final instalment of \$328,000 in July 2017
- in each month during the repayment period, Mupane must deliver at least 1,607 ounces of gold at a price for the gold selected by Samsung from the London gold fixing price, less a discount of 1.25%
- in each month following the repayment period and for such period as gold doré is produced Samsung will have the right to request delivery of all gold doré produced from the Tau ore body and the low grade stockpiles. The price for the gold produced will be London gold fixing price, less a discount of 2%
- in each month following the repayment period Samsung has been provided with the right of first refusal to purchase all gold produced from the Galane's operations in Botswana on terms that are no more favourable than offered by a third party
- the rate of interest on the outstanding balance is 3% per annum, compounded annually.

Frankly Samsung have looked rather generous and tolerant here. We suspect it is because they don't want the nightmare of taking over the Botswana operations by declaring Galane in default.

## Botswana Royalty

At the same time that the Samsung waiver was announced Galane also advised that it had agreed with the Government of Botswana that the royalties due on gold will continue to be deferred until June 2016. The amount deferred will then be repayable over 12 months commencing July 2017. While this gets the wolf from Galane's door it does not mean the money won't need to be paid, instead it will be coming out of funds further down the track.

## Earnings Outlook

The results statement for the last few quarters shows a fairly dismal picture with Gross Losses in all three reported quarters for the current financial year. Ounces produced were down substantially in all quarters compared to the same period of the previous year. The loss per share in the current year is higher than the company's stock price per share.

Galane Gold											
In Millions of USD											
	FY16e	FY15e	3Q14	3Q14	1Q14	FY14	4Q14	3Q14	2Q14	1Q14	FY13
Total Revenue	34.47	28.27	8.533	5.173	5.76	40.46	7.79	9.46	10.77	12.44	53.82
Cost of Revenue, Total	32.76	31.30	8.565	7.744	7.10	35.98	7.09	8.48	10.55	9.86	60.28
Gross Profit	1.71	-3.03	-0.032	-2.571	-1.34	4.49	0.22	0.98	0.22	2.58	-6.46
Selling/General/Admin. Expenses	2.10	2.15	0.516	0.547	0.59	2.51	0.79	0.639	0.61	0.47	2.81
Exploration	0.33	0.13	0.029	0.045	0.036	0.12	0.04	0.02	0.03	0.03	0.17
Depreciation/Amortisation	-	-	-	-	-	-	0.00	-	-	-	-
Interest Expense (Income)	0.52	0.32	0.17	0.14	-0.14	-0.58	-0.50	-0.08	0.00	0.00	-
Unusual Expense (Income)	0.00	0.00	0.00	0.00	0.00	0.00	-0.61	0.608	0.00	0.00	17.82
Forex costs (gain)	-0.45	-0.63	-0.38	0.01	-0.13	-	-	-	-	-	-
Other Operating Expenses, Total	0.32	0.29	0.271	-0.005	0.00	0.56	0.39	0.00	0.09	0.08	1.08
Total Operating Expense	35.58	33.55	9.17	8.48	7.45	38.58	7.19	9.67	11.27	10.44	82.15
Operating Income	-1.11	-5.28	-0.64	-3.31	-1.69	1.88	0.60	-0.21	-0.50	1.99	-28.33
Gain (Loss) on Sale of Assets	0	0	0	0	0	0	0	0	0	0	0.02
Income Before Tax	-1.11	-5.28	-0.64	-3.31	-1.69	1.88	0.60	-0.21	-0.69	2.12	-26.97
Tax	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.81
Post- Tax Income	-1.11	-5.28	-0.64	-3.31	-1.69	1.88	0.60	-0.21	-0.69	2.12	-28.78
Diluted Weighted Average Shares	86.70	54.50	52.837	52.823	52.82	54.584	52.54	52.677	52.54	51.53	50.36
Diluted EPS	-0.013	-0.097	-0.012	-0.063	-0.032	0.034	0.011	-0.004	-0.013	0.041	-0.571
Estimated Av. Au Price	\$1,180	\$1,090				\$1,190					
Ounces Au produced	29,210	25,035	7,637	4,829	5,030	30,791	6,044	8,206	7,195	9,346	31,586

Cash in the latest reported period was \$2.8mn at 30<sup>th</sup> of September down from \$9.6mn as at December 31st 2014.

In future earnings projections we have been generous in projecting a return to gross profits but with nothing in the way of information on how the Galaxy Gold asset might perform we may be mistaken. What is certain is that the shares on issue will blow out by around 30 million just on that transaction alone.

## Galaxy Gold - Helping Out a Friend in Need?

Usually rationalization in the mining industry is regarded by us as a good thing. However if the deal does not make sense and looks like it is helping out some "friends in need" we are less impressed. That was definitely the whiff arising from the announced merger earlier this year between Galane and Galaxy

Gold. Under share purchase agreements dated April 28, 2015 (and amended on Aug. 31, 2015, and Sept. 30, 2015) between five arm's-length parties and one non-arm's-length party, Galane shall acquire approximately 78% of the issued and outstanding shares of Galaxy, which is an operating and producing gold mining company located in Mpumalanga province in South Africa. One of the majority vendors of Galaxy Shares is Wayne Hatton-Jones , the Chief Operating Officer of Galane Gold . The proposed acquisition of 8,581,752 Galaxy Shares from him constitutes a "related party transaction".

In addition, the company shall also acquire the remaining 22% of Galaxy's outstanding shares from the minority shareholders.

In consideration, the company shall issue a total of 24,641,625 common shares and 5,478,964 share purchase warrants (each exercisable into one common share at a price of 17.5 cents for a two-year period) to the shareholders of Galaxy. Upon issuance of the shares in the initial merger, the majority vendors of Galaxy Shares will hold an aggregate of 26.8% of the issued and outstanding Common Shares on an undiluted basis, or 30.9% assuming the exercise of the Warrants and no other convertible securities. If all of the remaining shareholders of Galaxy tender their share, then the shareholders of Galaxy, including the majority vendors, will hold 31.8% of Galane on an undiluted basis, or 36.6% assuming the exercise of the Warrants and no other convertible securities of Galane.

Over and above this the company shall also issue up to \$8.5mn of convertible debentures to certain shareholders/creditors of Galaxy to settle outstanding operating advances provided to Galaxy. These debentures shall carry an interest rate of 4% per year, mature in four years and be convertible into common shares at a price of \$1 per share of principle outstanding. Whether this includes Hatton-Jones was not apparent from the releases we perused. Taking on this debt more than doubles the company's current debt burden.

### **Galaxy Gold's Asset**

Galaxy's mining assets are located on the Barberton Greenstone Belt, approximately 10 km to the west of Barberton in the Mpumalanga Province of South Africa and include several historical mining operations as well as tailings storage facilities comprised of previously mined and processed material. Historic production commenced in the 1880s. To date, the mining assets have produced over one million ounces of gold.

Galaxy's existing processing plant is in need of refurbishment and seems to be non-functioning at the current time. It consists of a crushing, milling, flotation, thickening, Biox, carbon in leach, elution and tailings disposal set-up designed to treat 16,000 tonnes per month. Galane claims that this facility can be expanded through refurbishment and the introduction of larger mills and flotation equipment. After hearing similar claims about the Botswanan assets in 2014, we now are sceptics.

We note that when Galaxy was first mentioned as listing on the Johannesburg Stock Exchange in 2010, it had plans to raise between 250 million-400 million rand through the listing and one or more private placements. Those funds were to be used to meet a production target of 53,000 tonnes per month by December 2011. Obviously the production target has gone the way of all things and a sale of the entity to Galane for debt/equity of slightly over \$10mn shows a fairly massive destruction of value at Galaxy over the intervening years.

## London Listing and its Pitfalls

This name has been mooted amongst those that might make the jump to the AIM market in light of the Africa focus being better understood in London. However, it should be remembered that the London market is very unforgiving and there are quite a lot of London investors who are aware of the evolution of other matters in the corporate grouping of which Galane is part, and they are far from happy campers. The situation has been made worse by the recent corralling of a sometime Turkish explorer into the same corporate “grouping” as Galane, with a shared director. The connection is fairly inescapable with both companies now ensconced at 181 Bay Street, Toronto.

Therefore any dipping into the London waters by Galane may be fraught with perils in light of the bad vibes circulating on this side of the pond.

## Risks

When we wrote our last note we listed the prime risks as being:

- ✗ Gold price weakness
- ✗ Technical problems with the mine reopenings
- ✗ Budget overruns on the capex
- ✗ Cash opex in an age of weakening gold

It would appear that everything that could go wrong did go wrong with the added icing on the cake now of South African risk. As if shareholders in the gold space don't have enough worries!

## Conclusion

How things change. Merely one year ago, Galane was cashed up (indeed trading at a significant discount to its cash on hand) with a plan to revive a string of pits and work its way through sizeable stockpiles. It even had an offtaker/sugardaddy in the form of Samsung which it had taken on in a novel deal.

One year later the cash is severely whittled down, losses have ballooned, gold production has slumped and the company has launched itself on a distracting and dilutive acquisition of a gold miner in South Africa. That is a real downer for investors that thought they were getting Botswanan risk (i.e. negligible) and instead find themselves in one of the least attractive jurisdictions in the mining world these days. What's more the latter transaction is being cooked with a non-arm's length party. To top this off the company had to request a payment standstill with Samsung and a royalty amnesty with the Botswanan government. Debt from the South African deal doubles liabilities.

Attempts to reduce costs have proven rather fruitless with mining/processing costs sometimes even exceeding mining revenues in recent quarters. It is no wonder that the stock price has slumped.

In light of the unexpected move into South Africa and the intractable losses in Botswana, we have added a **Short** position in Galane Gold to the Model Mining Portfolio with a 12-month target price of CAD\$0.03.



## Important disclosures

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