



# HALLGARTEN & COMPANY

## Results Note

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

<b>Key Metrics</b>			
Price (CAD)	\$	0.110	
12-Month Target Price (CAD)	\$	0.03	
Upside to Target		-73%	
High-low (12 mth)		\$0.025 - \$0.19	
Market Cap (CAD mn)	\$	15.69	
Shares Outstanding (millions)		142.6	
Fully diluted (millions)		162.1	
		<b>2015</b>	<b>2016e</b>
Consensus EPS			n/a
Hallgarten EPS (est.)			n/a
Actual EPS		(\$0.155)	(\$0.02)
P/E		n/a	(\$0.02)
		n/a	n/a

# Galane Gold

## That Sucking Sound...

- + The gold price has moved to a higher range but now appears stuck
- + June quarter results showed a tiny profit of \$99,000
- + Gold production in 2Q16 back at levels not seen since 3Q14
- ✗ The debt mountain is shortly going to start having cashflow consequences as delayed payments from last year kick in from October 2016 onwards
- ✗ The company is claiming to fund the Galaxy reboot out of cashflows from Botswana without explaining how this meshes with debt repayment requirements
- ✗ BEE partner not found yet and problematical due to sizeable debt appended to the South African assets
- ✗ Stock well off its highs of June
- ✗ Company is spending virtually nothing on exploration
- ✗ Option package to management announced with June results with exceedingly generous terms

### Trouble in Paradise

Back in his days as a US Presidential contender, Ross Perot, once referred to that “sucking sound south of the border” and he was referring to the sound of jobs flowing south into Mexico. These days one might be excused for wondering what the “sucking sound north of the border” might be. No need to be concerned though (unless you are a Galane Gold shareholder) because it’s only the management hoovering up options for their troubles.

In this piece we shall look at a couple of accounting nuggets (the only one’s one gets from Galane) that were contained in the “much awaited” June quarter results. These are the option issue and the soon to be rapidly escalating debt repayment and servicing schedule.

### Options – Fill Yer Boots

As if the management didn’t have enough stock, the latest results statement came with a rider relating to the grant of stock options to certain officers and directors. This comes on top of some of the management having purchased the lamgold stake for 1 ct per share and launching a very dilutive rights issue, also at 1 ct per share.

These latest options are to purchase up to 8,200,000 common shares and were granted with a five-year term and an exercise price equal to the greater of CAD 11.5 cts per share (the closing price of the common shares on the TSX-V on August 18, 2016). This was convenient considering the price had mainly been above that level for the best part of two months.

These options shall vest according to the following schedule:

- 10% vest on the date of grant
- 10% vest on the first anniversary of the date of grant
- 15% vest on the second anniversary of the date of grant
- 32.5% vest on each of the fourth and fifth anniversary of the date of grant

One might be tempted to get angry about the immediate vesting but the stock price failed to maintain that level so that was rather fitting. One might instead question why the grant was so generous and what did management do to deserve this after years of negative quarters? The profit of a mere \$99,000 on revenues of \$9.34mn in a fairly strong gold price scenario represents a net margin of around 1%. Nothing to write home about.

### Debt - Chickens Coming Home to Roost

Below can be seen a table from the June quarter results showing the current state of liabilities at Galane Gold.

<b>Interest-bearing loans and borrowings:</b>		<b>30-Jun 2016</b>	<b>31-Dec 2015</b>
<b>Current</b>			
Secured Facility Mupane	\$	2,553,000	\$ 1,033,808
Secured Facility Galaxy		-	\$ 3,249,433
Shareholder Loans Galaxy	\$	702,194	\$ 1,306,914
Capital lease obligation	\$	129,193	\$ 119,450
<b>\$ 3,384,387</b>	<b>\$</b>	<b>3,384,387</b>	<b>\$ 5,709,605</b>
<b>Non-Current</b>			
Debentures (1)	\$	5,733,042	\$ 1,720,518
Mining Royalties (2)	\$	5,178,346	\$ 4,188,464
Secured Facility Mupane (3)	\$	328,000	\$ 1,990,000
Capital lease obligation (6)	\$	239,138	\$ 296,584
	\$	11,478,526	\$ 8,195,566

As if it needs reinforcing, our view on the unattractiveness of the Galaxy deal is strengthened by yet more debt that came with this operation.

### Galaxy Debentures

This is the debt obligations that Galane took on when acquiring Galaxy Gold last year. At the time the company issued unsecured debentures to certain Galaxy loan holders and other parties as settlement of

amounts previously due for Galaxy. The terms of the debentures are as follows:

- ✘ Initial principal amount - \$5,650,268.
- ✘ Principal repayment - on November 20, 2019.
- ✘ Interest rate - fixed rate of 4% per annum, compounded annually and payable on the principle repayment date.
- ✘ Convertible into common shares at a price of CAD\$0.58 per share, based on a pre-determined exchange rate, with interest convertible into common shares, based on a pre-determined exchange rate, at a price equivalent to the greater of CAD\$1.00 and the Discounted Market Price (as defined by the TSX Venture Exchange) at the time of conversion, subject to acceptance of the TSX Venture Exchange.

### **Traxys Debt**

On the acquisition of Galaxy, the Galane fair valued a secured facility with Mine2Market SARL at \$3,249,433 which represented the settlement amount agreed between the parties subsequent to the year end. Galane issued an unsecured debenture as settlement of the amount agreed between the parties in March 2016. We gather this debt originated from Galaxy's inability to deliver to the trading house because it did not get to production. Sound familiar?

### **Galaxy Shareholder Debt**

There are numerous shareholder loan agreements that Galane inherited from Galaxy denominated in South African Rand and these come with some very ritzy interest rates. Considering that shareholders were looking like seeing the inside of a bankruptcy court as Galaxy faltered last year it is difficult to understand how they managed to come out of this with such a sweet deal. The terms of the agreements are:

- ✘ the rate of interest is between 15% per annum and South African prime rate plus 6% calculated and compounded monthly
- ✘ the amounts outstanding are repayable on demand

### **The Debt to Botswanan Government**

Most government's look dimly upon taxpayers that do not cough up what they owe. But presumably because Galane employs quite a few people in the country it managed to wangle a sweet deal when it fell into arrears in its payments of royalties in 2015. At the time the Government of Botswana agreed to the deferral of royalties payable on the sale of gold under the following terms:

- ✘ Royalties due to June 2016 have been deferred until July 2017
- ✘ Repayment of royalties due to June 2016 to commence in July 2017 over 12 months
- ✘ Interest to be charged from the 1<sup>st</sup> of July 2017 at Bank of Botswana commercial bank prime lending rate plus 5%

The deferral amount is unsecured.

## Samsung Debt

Originally we had lauded this as a breakthrough deal where an electronics company put forward cash to ensure supplies of gold for its operations. After the experience Samsung has had we doubt they will be in a rush to do this again. Galane had to return to the Korean company on bended knees in 2015 to request a renegotiation of terms as it was unable to service the debt. Galane had originally entered into a loan facility and gold prepayment agreement with Samsung C&T UK Ltd. in August 2014.

On November 5, 2015 Galane agreed with Samsung new terms with regards to the loan facility and gold prepayment agreement. The Samsung facility was amended such that:

- ✘ 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 nine 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 any one of the four London Bulletin AM or PM dollar gold fixing prices falling either on the delivery date or on the day immediately following the Delivery Date, less a discount of 1.25%
- ✘ in each month following the repayment period and for such period as gold dore is produced Samsung will have the right to request delivery of all gold dore produced from the Tau ore body and the low grade stockpiles. In each case the price for the gold produced can be selected by Samsung from any one of the four London Bulletin AM or PM dollar gold fixing prices falling either on the delivery date or on the day immediately following the delivery date, 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 Company'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
- ✘ the facility is secured by a first charge against the assets of Mupane

This arrangement kept the wolf from Galane's door for an extra year but the paying of the piper will begin soon as the \$20,000 per month being repaid shall shortly (in just over a month) balloon to \$277,000 per month, consuming most of its cashflow. Some are rather blithe about this thinking that Galaxy will start production and all will be right in the world. As Traxys and other unfortunates that heard this story about Galaxy in the past can attest there is many a slip twixt cup and lip when it comes to gold mine reactivations in Barberton. If Galaxy does not come in on time or has cost overruns or cash drains away from Botswana operations or into GS&A then a cash crunch would look possible.

## Latest Results

The company turned in a small net result for the June quarter. Considering how strong gold was in that period, this is the least we might demand of the company. Still its net margin was a mere 1% and the P&L scarcely features any of the servicing of the massive debt because most of that expense is deferred until 3Q16 and FY17.

<b>Galane Gold</b>											
<b>In Millions of USD</b>											
	<b>FY17e</b>	<b>FY16e</b>	<b>2Q16</b>	<b>1Q16</b>	<b>FY15</b>	<b>4Q15</b>	<b>3Q15</b>	<b>3Q15</b>	<b>1Q15</b>	<b>FY14</b>	<b>FY13</b>
Mine Revenue	47.75	35.70	9.34	7.35	26.23	6.76	8.533	5.173	5.76	40.46	53.82
Cost of Mine Revenue	43.67	32.67	8.12	8.16	34.45	11.04	8.565	7.744	7.10	35.98	60.28
Gross Profit	4.08	3.03	1.22	-0.82	-8.22	-4.28	-0.032	-2.571	-1.34	4.49	-6.46
Selling/General/Admin. Expenses	2.90	2.10	0.47	0.51	2.26	0.62	0.516	0.547	0.59	2.51	2.81
Exploration	0.18	0.06	0.007	0.007	0.115	0.01	0.029	0.045	0.036	0.12	0.17
Depreciation/Amortisation	-	-	-	-	-	-	-	-	-	-	-
Interest Expense (Income)	1.16	0.76	0.22	-0.12	0.69	0.53	0.17	0.14	-0.14	-0.58	-
Unusual Expense (Income)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	17.82
Forex costs (gain)	1.50	1.50	0.00	0.47	-3.02	-2.52	-0.38	0.01	-0.13		
Other Operating Expenses	1.23	1.40	0.421	0.45	0.245	-0.02	0.271	-0.005	0.00	0.56	1.08
Total Operating Expense	50.64	38.49	9.24	9.49	34.74	9.64	9.17	8.48	7.45	38.58	82.15
Operating Income	-2.89	-2.79	0.10	-2.14	-8.51	-2.88	-0.64	-3.31	-1.69	1.88	-28.33
Gain (Loss) on Sale of Assets	0	0	0	0	0	0	0	0	0	0	0.02
Income Before Tax	-2.89	-2.79	0.10	-2.14	-8.51	-2.88	-0.64	-3.31	-1.69	1.88	-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	-2.89	-2.79	0.10	-2.14	-8.51	-2.88	-0.64	-3.31	-1.69	1.88	-28.78
Diluted Weighted Average Shares	142.63	142.63	112.065	71.314	54.90	53.4	52.837	52.823	52.82	54.584	50.36
Diluted EPS	-0.020	-0.020	0.001	-0.030	-0.155	-0.054	-0.012	-0.063	-0.032	0.034	-0.571
Estimated Av. Au Price	\$1,275	\$1,280	\$1,260		\$1,148					\$1,190	
Ounces Au produced	38,200	26,210	7,855	5,828	24,321	6,825	7,637	4,829	5,030	30,791	31,586
Ounces Au sold			7,378	6,191	24,205	6,484	7,483	5,098	5,140		

### Conclusion

Hope springs eternal in the hearts of non-management shareholders at Galane Gold. Management know where their reward comes from (options amongst other things) while shareholders are rubbing their lucky rabbit's foot and hoping that the Galaxy Mine at Barberton doesn't prove to turn out a dud for Galane as it has done for previous owners. It will need more than luck to make the Galaxy Mine fly.

Meanwhile the company is saying it will meet the capex expense of the mine-start out of cashflow from the Botswanan operations. How this goes down with the multifarious creditors who are secured against the Mupane asset we can only guess at. And no explanation is given on how the company will fund BOTH the Galaxy reboot and the steeply rising debt repayments on the Samsung loan from October of this year.

Then there is the still unanswered question of how the company deals with its BEE obligations. With a lot of debt appended to the Galaxy asset and the South African subsidiary, we can see why BEE players are not lining up to get on board this African Queen.

Nothing in the June quarter results gives investors a warm fuzzy feeling unless they are content with a 1% net margin. We reiterate our dim view on this story and we have a **Short** position in Galane Gold in the Model Mining Portfolio and reiterate our 12-month target price of CAD\$0.03.



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