



HALLGARTEN & COMPANY

Results Note

Christopher Ecclestone
ceccestone@hallgartenco.com

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

Key Metrics				
Price (CAD)	\$	0.055		
12-Month Target Price (CAD)	\$	0.01		
Downside to Target		-82%		
High-low (12 mth)		.0045 - \$0.115		
Market Cap (CAD mn)	\$	8.07		
Shares Outstanding (millions)		146.8		
Fully diluted (millions)		161.4		
		2016	2017e	2018e
Consensus EPS			n/a	n/a
Hallgarten EPS (est.)			(\$0.029)	(\$0.028)
Actual EPS		(\$0.057)		
P/E		n/a	n/a	n/a

Galane Gold

The Crushing Debt Burden

- + Company continues squeezing some residual production out of its Botswanan assets
- + The debt with Samsung has finally been paid off
- + Supposedly the Galaxy Mine In South Africa will be revived in 2018
- + Company showed a profit in the most recent quarter from what looks like high-grading of its last resources in Botswana
- ✗ The company's credibility has been shredded in the eyes of investors by continual failure to deliver and failed ventures like the first Galaxy reboot and the run at Vantage Mines
- ✗ Lack of clarity on Galaxy includes no provision of costs or timetable on reopening to the market
- ✗ The company is playing a dangerous game of chicken in stiffing the Botswanan government on the debt repayments

Here We Go Again

Having managed to finally eke out a profit in 3Q17 Galane is now set on a course of reopening the benighted Galaxy mine. This will be the second time in 24 months that it has tried to reboot this operation. The pressure is now on though as Botswana has been milked to provide the gold to pay down the Samsung loan. With one piece of debt out of the way, the company now faces the even bigger pieces of the debt to the Botswanan government and the former Galaxy debtholders.

In this note we shall look at the recent results, the Galaxy situation and the debt overhang.

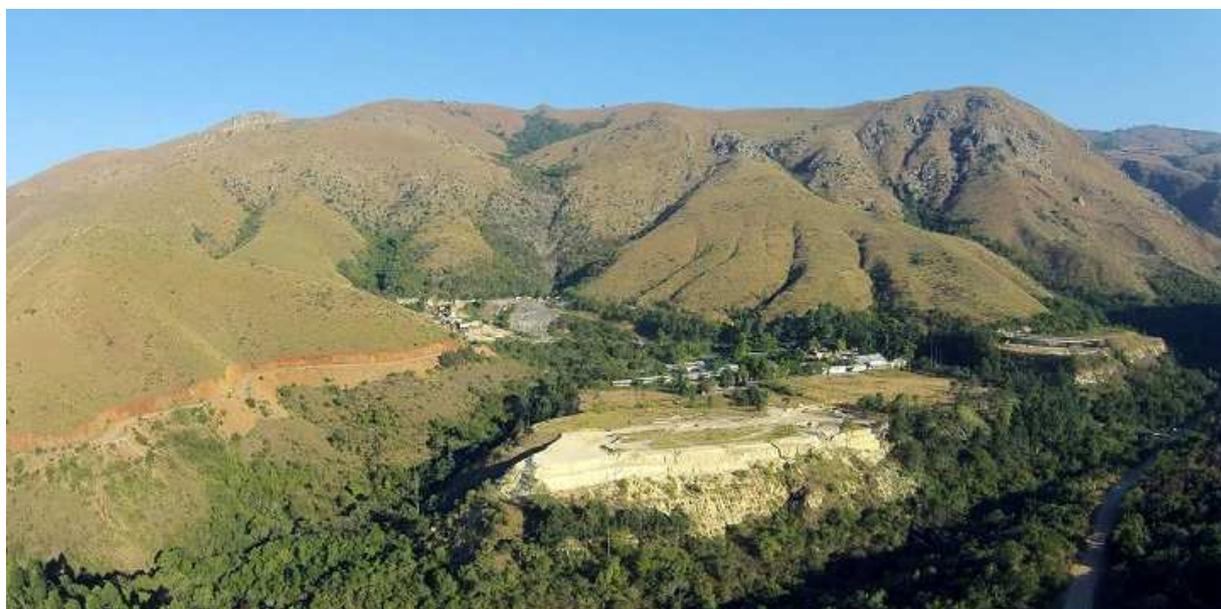
Galaxy

Galane, after much fanfare (and in line with our predictions), announced in January 2017 that the Galaxy Property did not generate positive cash flows and that further capital expenditures (which it did not have) were required to complete the full commissioning. Matters ground to a halt.

Now it is rewarming the Galaxy mines as it stares at the inevitability of the end of mining at Mupane. However to do this it must channel all its cashflow in the direction of the South African project, which then leaves the debt mountain issue unaddressed.

The company's promotional materials now speak of an average production of over 15,000 oz Au per annum with an all-in cost of US\$688 per oz as per the PEA published in early 2016. This used a ZAR rate of 11.7/USD compared to the current rate of 12.45/USD. To put the new production in perspective, Tau

produced over 19,000 ozs in the first nine months of 2017. So if Tau goes away and Galaxy is all that's left then production, by implication, might shift down to a new lower run-rate.



It was less than two years ago that the company said that “work has already commenced on an expansion plan to take annual production up to 60,000 ounces of gold”. So how are the mighty fallen.

Galaxy Mine - Resource Estimate			
<small>(August 2015)</small>			
Category	Tonnes	Grade Au g/t	Contained ozs
Measured	1,876,126	3.37	203,435
Indicated	4,350,781	2.85	399,261
Measured & Indicated	<u>6,226,907</u>	<u>3.01</u>	<u>602,696</u>
Inferred	8,095,521	3.4	886,199

Galaxy Mine - Mineral Reserve Estimate			
Category	Tonnes	Grade Au g/t	Contained ozs
Probable Mineral Reserves	<u>1,457,322</u>	3.37	169,586
Total Mineral Reserves	<u>1,457,322</u>	3.37	169,586

The company must be hoping that it can gussy up the projected nine-year LoM and the rather feeble sub-20K opa production target by bringing the Inferred into the M&I category and converting some of the M&I to Reserves. However years of watching this company (with its minuscule allocation to exploration) means that we remain skeptical it will devote the funds (or even has the funds) to do the work required to achieve these goals.

The 2016 Report – A Skinny NPV

As we spend much of our time wading through NI43-101 reports one gets to see the same type of general structure over and over again. Rather unhelpfully the classic soundbite of the NPV of the project in untranslated ZAR.

To the right can be seen the table of metrics that was included in the report.

Well, to be more precise the top half was included in the report. The bottom half is ours with the NPV and the peak funding requirement translated into current USD. When one does this one can see why the mine has been start/stop under both current and previous owners. With an NPV of a mere USD\$14.6mn one could comment that this scarcely looks worth the effort (and the capital put at risk). Something to us does not add up. The milled grade is high by modern standards and the breakeven cost per oz is low and yet even though the ounces per annum is nothing to write home about the NPV is pretty feeble for a 9-yr mine-life with such a short payback. What are we (or moreover they) missing here?

At the time of the report's publication the estimate of the initial capital amounted to ZAR 17.9 million. This was mainly on the plant upgrade and the shaft repairs that had to be done. However some of this was spent during the first attempt to restart the mine. No estimates are evident on how much the second reboot will cost.

Profitability Ratios

	Unit	Profitability
Total ounces in Reserve LoM plan	ozs	169,586
In-Situ Mining Inventory Valuation	USD/oz	\$70
Production LoM	Years	9
Present Value of Income flow	ZAR mn	182
Peak Funding Requirement	ZAR mn	36
Payback Period	Years	1
Break Even Milled Grade	g/t	3.15
Break Even/Incentive Gold Price	USD/oz	688

	Unit	Profitability
Total ounces in Reserve LoM plan	ozs	169,586
In-Situ Mining Inventory Valuation	USD/oz	\$70
Production LoM	Years	9
Present Value of Income flow	USD mn	\$14.62
Peak Funding Requirement	USD mn	\$2.89
Payback Period	Years	1
Break Even Milled Grade	g/t	3.15
Break Even/Incentive Gold Price	USD/oz	688

Samsung

The once-heralded loan arrangement with Samsung came to an end in the most recent quarter. As a reminder, Galane entered into a loan facility and gold prepayment agreement with Samsung C&T UK Ltd dated August 22, 2014. This needed to be amended in November 2015, February 2017, March 2017 and April 2017 due to the financial and performance difficulties at the Galane end. The last remaining scheduled payment was one monthly installment of \$328,000 in October 2017 which was paid (presumably out of production) and thus the lien over the Botswanan assets was released.

The company eluded in the news release to gearing up again using the now liberated security of the Botswanan assets to fund the Galaxy reboot.

The “Other Debt”

Galane owes amounts on unsecured debentures to certain Galaxy loan holders and other parties as settlement of amounts previously due on the acquisition of Galaxy in 2015. The terms of these debentures are as follows:

- ✘ Initial principal amount - \$5,650,269 repayable on the 20th of November 2019
- ✘ Interest rate - fixed at 4% per annum, compounded annually and payable on the principal repayment date
- ✘ The full amount of the principal is convertible into common shares at a price of CAD\$0.58 per share but this is unlikely as the stock languishes at one tenth of that level

Therefore the company has looming over it a pretty hefty repayment just under two years away.

Then there is the eternal bugbear of the (unsecured) royalties (\$7.6mn) owed to the Government of Botswana. Galane has been pushing its luck on this issue. The government clearly doesn't want to act in case it endangers jobs but in most other places a government creditor would have demanded that it be first in line to get paid. Several years back the government 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 July 1, 2017 at Bank of Botswana commercial bank prime lending rate plus 5%

Rather pathetically the company is engaged in “ongoing discussions” on the current terms of the deferred royalties and associated repayment with the Government of Botswana. The company seems to draw comfort, rather laughably, from the fact that the deferral amount is unsecured. If they don't know

that unpaid royalties to the government can shut down their mine in the blink of an eye (secured or unsecured) then they are either naïve or think that investors are naïve.

There are numerous shareholder loan agreements (amounting to \$927K) entered into in connection with the acquisition of Galaxy which are denominated in South African Rand. 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

Beyond this we might mention that in our experience listed companies in this corporate grouping are notoriously loose with the truth in reporting accurately the true indebtedness of the company. In fact the TSX is investigating one such omission in another company at this time.

Latest Results

On the following page one can see the updated earnings statement to the end of September. On past performance the company won't be reporting its annuals until May so this is all the story has to run on in the past. Sometimes it has announced production numbers for the quarter just ended when its suits it (i.e. when they look better than the market expects). So no announcement speaks for itself.

The production in 2017 showed the company ramping up the throughput to get the most out of what it has left in Botswana. Tau throughput doubled but the low-grade stockpile showed a large decline implying that this activity has a finite life.

		2017			YTD 2017	2016			YTD 2016
		Q3	Q2	Q1		Q3	Q2	Q1	
Mupane (Tau)	Ore (t)	108,615	79,753	61,373	249,741	48,070	46,656	49,657	144,383
	Grade (g/t)	3.04	2.74	2.83	2.89	2.68	3.46	2.96	3.03
	Waste (t)	16,968	14,911	9,326	41,205	15,543	13,645	7,261	36,449
Tekwane	Ore (t)	9,359	-	-	9,359	3,465	37,697	4,103	45,265
	Grade (g/t)	2.25	-	-	2.25	0.48	0.48	0.44	0.48
	Waste (t)	20,701	-	-	20,701	-	33,695	8,916	42,611
Low Grade Stockpiles	Ore (t)	72,687	68,481	89,371	230,539	177,207	187,275	120,469	484,951
	Grade (g/t)	0.89	0.87	0.82	0.86	0.80	0.79	0.77	0.79

The third quarter (with a static gold price) still managed a profit and well it should considering that production volumes were up around 40%. We suspect that volumes will be down in Q4 and indeed that Q3 represents the highest volumes this company will see.

Taking the talk of the Galaxy reboot at face value we have factored in higher volumes and revenues in 2018 but no higher profits.

Galane Gold												
In Millions of USD												
	FY18e	FY17e	3Q17	2Q17	1Q17	FY16	4Q16	3Q16	2Q16	1Q16	FY15	FY14
Mine Revenue	39.80	36.34	11.80	8.21	6.73	32.66	7.58	8.40	9.34	7.35	26.23	40.46
Cost of Mine Revenue	37.70	35.47	9.99	8.13	9.26	33.97	9.30	8.39	8.12	8.16	34.45	35.98
Gross Profit	2.10	0.87	1.81	0.09	-2.53	-1.31	-1.72	0.01	1.22	-0.82	-8.22	4.49
Selling/General/Admin. Expenses	1.90	1.90	0.57	0.47	0.49	2.10	0.48	0.64	0.47	0.51	2.26	2.51
Exploration	0.50	0.21	0.057	0.05	0.034	0.026	0.01	0.006	0.007	0.007	0.115	0.12
Depreciation/Amortisation	-	-	-	-	-	-	-	-	-	-	-	-
Interest Expense (Income)	2.25	2.15	0.63	0.53	0.49	0.86	0.53	0.23	0.22	-0.12	0.69	-0.58
Unusual Expense (Income)	0.00	0.00	-	-	0.00	0.00	-	-	0.00	0.00	0.00	0.00
Forex costs (gain)	1.20	0.57	-0.07	0.05	0.41	1.71	0.33	0.91	0.00	0.47	-3.02	-
Other Operating Expenses	0.40	0.23	-0.655	0.308	0.31	0.66	-0.01	-0.197	0.421	0.45	0.245	0.56
Total Operating Expense	43.95	40.53	10.52	9.54	10.99	39.32	10.62	9.98	9.24	9.49	34.74	38.58
Operating Income	-4.15	-4.19	1.29	-1.33	-4.26	-6.66	-3.04	-1.58	0.10	-2.14	-8.51	1.88
Gain (Loss) on Sale of Assets	0	0	0	0	0	0	0	0	0	0	0	0
Income Before Tax	-4.15	-4.19	1.29	-1.33	-4.26	-6.66	-3.04	-1.59	0.10	-2.14	-8.51	1.88
Tax	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Post- Tax Income	-4.15	-4.19	1.29	-1.33	-4.26	-6.66	-3.04	-1.59	0.10	-2.14	-8.51	1.88
Diluted Weighted Average Shares	147.00	146.00	146.804	146.285	145.732	117.59	142.625	142.618	112.065	71.314	54.90	54.584
Diluted EPS	-0.028	-0.029	0.009	-0.009	-0.029	-0.057	-0.021	-0.011	0.001	-0.030	-0.155	0.034
Estimated Av. Au Price	\$1,250	\$1,275	-	-	-	\$1,247	\$1,204	\$1,328	\$1,260	-	\$1,148	\$1,190
Ounces Au produced	32,000	28,000	9,535	6,709	4,298	26,783	6,857	6,243	7,855	5,828	24,321	30,791
Ounces Au sold	-	-	9,251	6,545	5,531	26,188	6,293	6,326	7,378	6,191	24,205	-

Conclusion

The clock is ticking against Galane Gold. It managed to eke more production out of its Botswanan assets by high-grading Tau. This had the effect of keeping the Botswanan government (its biggest creditor) at bay. However high-grading means the mine's end of life draws nearer faster with the double whammy that when the redundancy notices go out and the shutters are pulled down the government will have no economic benefit from Galane and no leverage to get its money repaid. This is not going to be pretty.

So with this gun against its head (if it feels any compunction at all) the company is now trying to revive the Galaxy mine, that stop-start effort from 2016. To do this the cashflow of Tau that should really be going to debt repayment, is going towards a new/old (and problematic) venture.

Past performance does not augur well for the Galaxy mine reopening. Without it the company has nothing but a pile of debt and no revenue sources beyond a declining Tau production stream..

With this woeful background in mind we reiterate our **Short** position in Galane Gold in the Model Mining Portfolio and we maintain our 12-month target price of CAD\$0.01.



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