



HALLGARTEN & COMPANY

Results Note

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

Key Metrics			
Price (CAD)	\$	0.16	
12-Month Target Price (CAD)	\$	0.03	
Upside to Target		-81%	
High-low (12 mth)		\$0.025 - \$0.19	
Market Cap (CAD mn)	\$	22.82	
Shares Outstanding (millions)		142.6	
Fully diluted (millions)		142.6	
		2015	2016e 2017e
Consensus EPS			n/a n/a
Hallgarten EPS (est.)			(\$0.03) (\$0.02)
Actual EPS		(\$0.155)	
P/E		n/a	n/a n/a

Galane Gold

Share Price Ramp a False Dawn

- + The gold price has moved up but is now stabilizing below its recent peak
- + Gold production in 2Q16 back at levels not seen since 3Q14
- ✗ The results for March qtr of 2016 continue to show losses at both the bottom line and the gross margin
- ✗ Revenues declined further from Q3 and the company showed a substantial gross loss
- ✗ Cash has plunged and debt has risen steadily
- ✗ Deep discount rights issued brutalized though shareholders unwilling or unable to participate
- ✗ Company is spending virtually nothing on exploration, \$7,000 in the whole of the March quarter
- ✗ Recent announcement gives the impression that Galaxy mine will be producing 60,000 ounces per annum when it will be lucky to reach 18,000 opa
- ✗ There is a legal dispute related to land on which key elements of the South African mine are located

Fool me Twice...

There is an old expression that goes “Fool me once, shame on you, fool me twice, shame on me” and that comes to mind with the “second wind” of Galane Gold where indiscriminating investors have stormed back into the stock despite absolutely nothing having changed in its prospects beyond gold being up 23% for the year. While this would be a gift to most gold miners, history has shown that Galane Gold indulges in reverse alchemy and can turn gold into Lead. The most recent results which we shall examine here show the company still wallowing in losses.

However we are not fooled as Galane Gold is not a beast that has changed its spots, indeed it just remains as shaggy a beast as it ever was. Moreover it stands on the cusp of a new debacle as it tries to make its misbegotten purchase of Galaxy Gold’s South African asset into something beyond the flightless bird it has been for past owners.

Bad to Worse

If the March results were supposed to bring much consolation, but with a negative bottom line of \$2.14mn, they did not as they were the third largest losses in the last eleven quarters.

It is difficult to be more negative about this stock than we are, but we were even surprised at the dire results the company posted for the December quarter and FY2015. It is no surprise though that they waited until after the market close on the very last day for filing as the company is also in the throes of a

right issue. However, sooner or later, the inevitable filing was going to weigh upon the outcome of the financing as the close date is within the first week of May. In effect shareholders of the company were asked to stump up cash (or be brutally diluted) whilst they remained in the dark as to how the company had done in the last fiscal year.

Now we have the first quarter results in which are also dire and by the end of August, we should be seeing the June quarter numbers. The company has rather selectively released gold production number for the June quarter but nothing else.

The Back-Story on 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 back in 2014 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 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 since 2014 with spiraling losses, a forced renegotiation of offtake and royalty deals and then in late 2015 it announced its entry into South African gold mining, via the acquisition of Galaxy Gold, with its mothballed mine.

Earnings Remain Dire

Those that had hoped for a turnaround in 2016 were disappointed when the March quarter results were announced at the end of May. To summarise the results in short we would note:

- Declining revenues
- Still reporting a gross loss
- Lower gold production than the December quarter and company sold gold from previous quarters production to boost Q1 revenues
- Negative bottom line with over \$2mn loss
- Gold in process fell, as did ore stockpiles
- Underground mining costs around \$250 per oz more than the surface mining, open pit and tailings workovers that the company has focused on in recent times
- Higher debt
- Brutal dilution due to the Galaxy Gold transaction and the rights issue
- Forex losses are incorrectly reported as a gain in the version of accounts filed with SEDAR
- The company recorded “on-going costs” of \$453,000 relating to the Galaxy “asset”

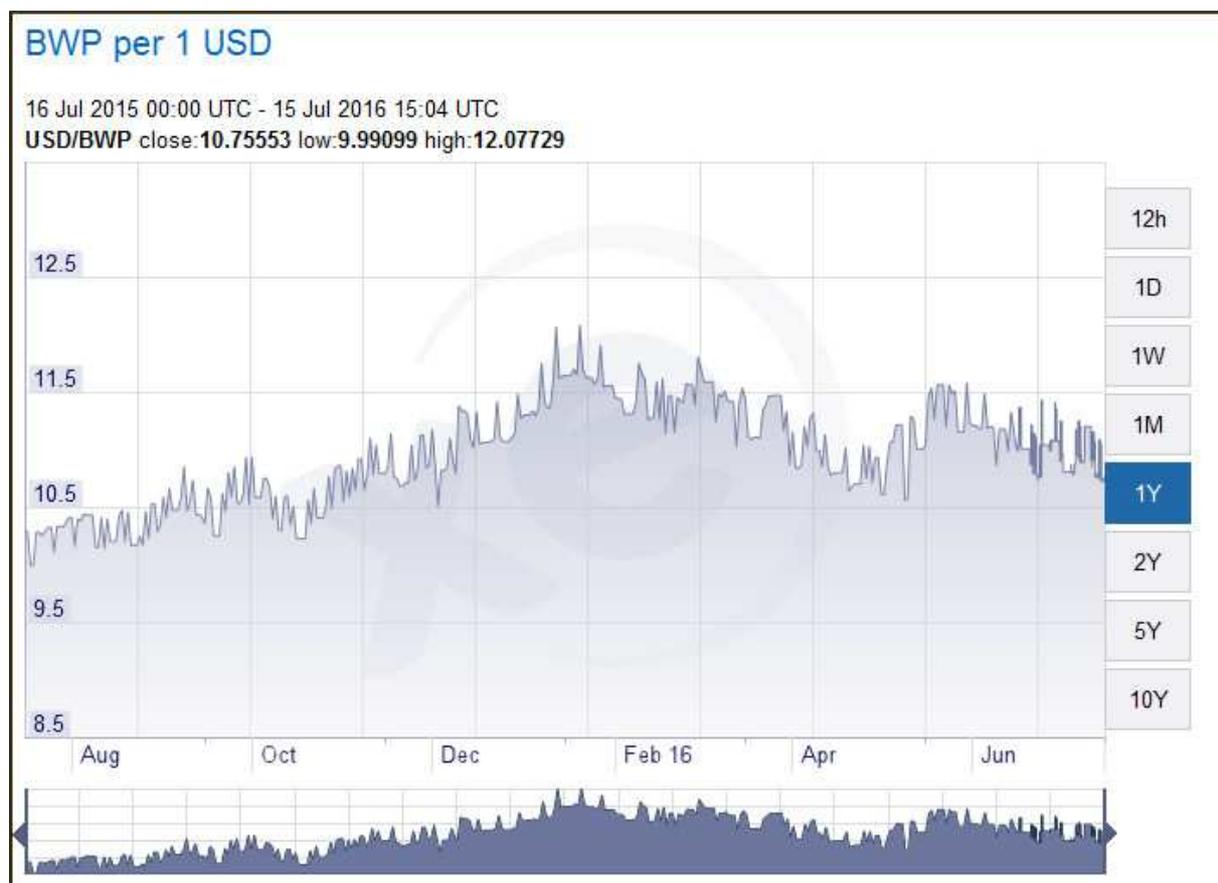
It is important to note that revenues in 1Q16 were inflated by the company selling 350 ozs of gold more

than it produced, so essentially these were deferred sales from the previous year. These boosted topline revenues by around \$420,000 in the quarter, by our calculations.

Operating cash cost per ounce in Q1 was around \$250 higher than in the preceding quarter, with much of this due to the shift to the higher cost underground mining. This is a situation that should be accentuated in coming quarters as Mupane makes up a greater proportion of the production mix. Thus higher operating costs will consume ALMOST ALL the extra revenue from the higher gold price.

Interestingly it would appear that having been stung by our analysis of the foreign exchange exposures in our previous research note the company has decided to not show the breakdown of exposures to the Botswanan Pula, South African Rand and US dollar in the same way as before.

In light of the amounts owed, in physical gold, to Samsung we find it hard to believe that Samsung will accept having to pay the higher current price for gold under its arrangements when the company failed to deliver in FY15 on its commitments under its agreements with Samsung.



Liabilities (short- and long-term) stood at around \$27mn as at the end of the March quarter, unchanged since the end of the December quarter. This is an exceptionally high level of indebtedness for a junior miner of such scant production potential.

Galane Gold											
In Millions of USD											
	FY16e	FY16e	2Q16e	1Q16	FY15	4Q15	3Q15	3Q15	1Q15	FY14	FY13
Mine Revenue	47.75	35.70	10.29	7.35	26.23	6.76	8.533	5.173	5.76	40.46	53.82
Cost of Mine Revenue	43.67	34.67	9.20	8.16	34.45	11.04	8.565	7.744	7.10	35.98	60.28
Gross Profit	4.08	1.03	1.09	-0.82	-8.22	-4.28	-0.032	-2.571	-1.34	4.49	-6.46
Selling/General/Admin. Expenses	2.90	2.10	0.54	0.51	2.26	0.62	0.516	0.547	0.59	2.51	2.81
Exploration	0.18	0.06	0.01	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	0.25	-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	0.33	0.47	-3.02	-2.52	-0.38	0.01	-0.13		
Other Operating Expenses	1.23	0.92	0.22	0.45	0.245	-0.02	0.271	-0.005	0.00	0.56	1.08
Total Operating Expense	50.64	40.01	10.55	9.49	34.74	9.64	9.17	8.48	7.45	38.58	82.15
Operating Income	-2.89	-4.31	-0.26	-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	-4.31	-0.26	-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	-4.31	-0.26	-2.14	-8.51	-2.88	-0.64	-3.31	-1.69	1.88	-28.78
Diluted Weighted Average Shares	142.63	142.63	142.63	71.314	54.90	53.4	52.837	52.823	52.82	54.584	50.36
Diluted EPS	-0.020	-0.030	-0.002	-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				6,191	24,205	6,484	7,483	5,098	5,140		

Production

Gold production in 1Q16 was 5,828 ounces compared to 5,030 ounces in 1Q15 and yet the results for the period were actually worse than a year before. This was despite the oil price and currency kickers and the company selling over 350 ounces from inventories as well as what was produced in the quarter. Without this extra selling topline revenues would have been maybe \$420,000 lower and losses higher accordingly.

Galaxy – Throwing Good Money after Bad

The company just announced a US\$2mn capital expenditure program on the first phase of the recommencement of production at the Galaxy gold mine in South Africa which will be financed from internal cash flows primarily from the company's operations in Botswana. It is claiming that there will be gold produced before the end of 2016.

The first phase of the capital project will commence in July 2016, and is designed to refurbish existing infrastructure and upgrade the processing facility to take production to 18,000 ounces per annum. The announcement's headline gave investors the impression that production would be 60,000 but that is only a target number after various phases of investment.

The first phase covers the following steps:

- The refurbishment of the existing 15,000-tonne-per-month processing plant, which will include the installation of a new crusher, remedial work to the float section, a new gravity separation section and re-establishment of the elution plant;
- The construction of a new 25,000-tonne-per-month carbon-in-leach tailings retreatment plant within the current footprint of the existing processing plant;
- The recommencement of underground mining at Woodbine, Agnes and Ivy on 17 levels using conventional shrink stope mining;
- The commencement of tailings recovery by sluicing at the Woodbine and Hostel dumps.

The company claims that it “will be using positive cash flows from its other operations and, as a result, expects current cash reserves to remain as currently reported” in the second half of 2016.

The second major goal for Galane this year is to recommence production at Galaxy. Having achieved our first goal to commence mining in the main ore body at Tau, management of the company can now concentrate on the implementation of the first phase of this project at Galaxy.

The Balance Sheet

The balance sheet of the company at the end of March and the two preceding Decembers is shown below.

The current financing brought in around \$700,000 which should be added to the March-end cash balance, but then the on-going bleeding from operations should be taken into account and servicing costs are surprisingly light

Galane Gold - Balance Sheet			
	March End 2016	Dec End 2015	Dec End 2014
Current assets:			
Cash	2,196,831	1,887,179	9,653,807
Trade receivables and other current assets	612,360	859,454	1,837,530
Inventories	7,946,280	8,729,705	6,337,040
	<u>10,755,471</u>	<u>11,476,338</u>	<u>17,828,377</u>
Non-current assets:			
Mining properties	33,582,357	34,196,825	21,594,417
Plant and equipment	2,534,068	2,607,674	1,885,585
Ore stockpiles			5,911,946
	<u>36,116,425</u>	<u>36,804,499</u>	<u>29,391,948</u>
	<u>46,871,896</u>	<u>48,280,837</u>	<u>47,220,325</u>
Current liabilities:			
Accounts payable and accrued liabilities	8,963,776	8,538,785	6,635,834
Interest-bearing loans and borrowings	2,596,618	5,709,605	4,667,416
	<u>11,560,394</u>	<u>14,248,390</u>	<u>11,303,250</u>
Non-current liabilities:			
Interest-bearing loans and borrowings	11,667,810	8,195,566	4,020,218
Warrants denominated in a foreign currency	115,822	113,349	
Restoration and rehabilitation provision	3,793,105	3,656,728	3,083,251
	<u>15,576,737</u>	<u>11,965,643</u>	<u>7,103,469</u>
Shareholders Equity	<u>19,734,765</u>	<u>22,066,804</u>	<u>28,813,606</u>
	<u>46,871,896</u>	<u>48,280,837</u>	<u>47,220,325</u>

As can be noted debt has ballooned from \$18.4mn to over \$27mn, while cash has shriveled from nearly \$10mn to a bit over \$2mn. Shareholders' funds have diminished in accord with the losses despite the all-stock acquisition of Galaxy Gold.

We would repeat our previous comment that everything that could go wrong has gone wrong (except the gold price) in recent times with the added icing on the cake now of South African risk.

Conclusion

In a perverse state of affairs, investors in this stock seem to think that because the share price rose dramatically that something had actually changed at Galane Gold. However with the shareholders heavily diluted and the "cashflow" from the heavily loss-making Botswanan operations now being channeled towards reviving the historically troubled Galaxy Mine in South Africa, we fail to see where

the “turn” is for this stock.

Usually a company with severe operating problems at its existing mines, that is also heavily haemorrhaging cash, focuses on rectifying their existing problems. Instead Galane resolved in late 2015 to double-down with the purchase of a mothballed mine in South Africa with multiple legal complications. We have seen no sign of these legal complications having been resolved. It is difficult to say which of the problems is worse, but definitely the lack of a BEE partner stands out as a major credibility issue for the company, and a further source of dilution.

The bottom-line is still a sea of red, and the gold price rise while mitigating this does not solve the problem that the Botswanan operation is hand-to-mouth and is now expected to feed the capex requirements of the South African start-up as well.

Fans of this stock fail to note that it is one of the smallest producing juniors with one of the heaviest debt burdens. Currently it carries over \$27mn in debt of which over \$14mn is interest-bearing. While ASX investors have been able to stomach debt on their junior producers’ books, the legions of TSX investors have rarely been so tolerant. Moreover, we are talking here of a company that is not only sinking in debt but losing money at the same time. This is a classic example of ‘whistling past the graveyard”.

We regard Galane Gold as a **Short** position and reiterate our 12-month target price of CAD\$0.03.



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