

HALLGARTEN & COMPANY

Results Note

Christopher Ecclestone
ceccestone@hallgartenco.com

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

Key Metrics		
Price (CAD)	\$	0.095
12-Month Target Price (CAD)	\$	0.01
Downside to Target		-89%
High-low (12 mth)		\$0.05 - \$0.19
Market Cap (CAD mn)	\$	13.84
Shares Outstanding (millions)		145.7
Fully diluted (millions)		165.2
	2016	2017e
Consensus EPS		n/a
Hallgarten EPS (est.)		(\$0.062)
Actual EPS	(\$0.057)	
P/E	n/a	n/a

Galane Gold

Russian Roulette

- + Company continues squeezing some residual production out of its Botswanan assets
- ✘ The company has rewarmed a proposal to “acquire” the South African assets of Vantage Goldfields, a delisted ASX miner, out of administration
- ✘ The Lily mine of Vantage is currently shuttered after a fatal mine disaster
- ✘ The June 16th deadline for the LOI has passed and in typical form the company has kept the market uninformed with no update or notice that deal is dead
- ✘ Operating results continues to be disastrous in 1Q17 and in fact worsened with the largest quarterly loss ever of \$4.26mn
- ✘ Even this “result” was achieved by selling 25% more gold than the company produced
- ✘ The Galaxy reboot has flopped with the asset decreed to be “not fully commissioned” before it even entered production
- ✘ Cashflows from Botswana have been totally committed to debt repayment requirements
- ✘ Debt repayments looked insurmountable BEFORE the supposed Vantage deal therefore how that asset will be “acquired” or funded remains unclear

Fool me once.....

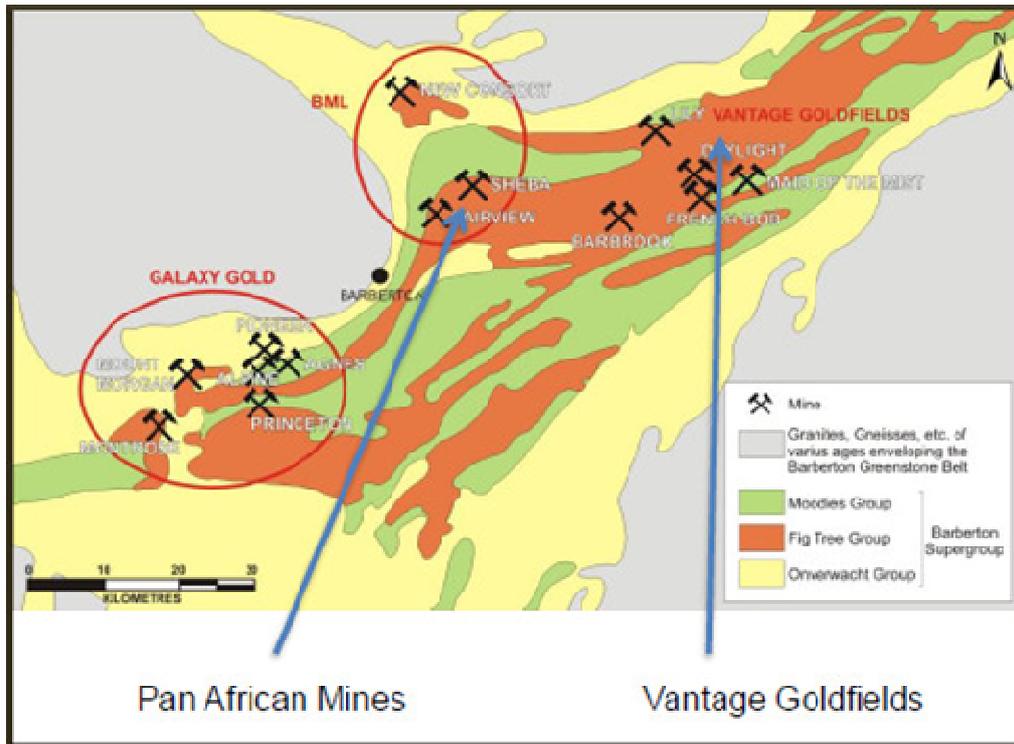
....shame on you... Fool me twice shame on me. A few weeks back we published a Short note on this stock in which we highlighted the dire financial state and yet breathed a sigh of relief that the rumoured takeover of Vantage Goldfields (which we had informed investors of last December) had gone away. How wrong we were.. We had presumed that a company that was essentially out of money would not advance with this transaction and then lo and behold, a few days later it did indeed announced (in a fashion) that it was “acquiring” Vantage Goldfields.

The feeble-minded in the investment community rushed in where experts feared to tread and pushed the stock up to over ten cents in a feeding frenzy related to a listed, over-indebted and cashfree company with strong negative gross and operating margins “acquiring” a delisted company with its main subsidiary in liquidation due to a collapsed mine. Then simultaneously the company announced 1Q17 results that showed an even more severe decline in margins and a diabolical bottom line and a ballooning in debt costs with a record loss at the bottom line. Our mistake was in thinking that one virtually bust company acquiring a definitively bust company was not theoretically or physically possible (and this will probably still prove to be the case). The market however was content to throw logic to the four winds in grasping at the straws of a brief respite in the litany of woes.

Vantage Goldfields

Jungle drums are rarely heard in Barberton, because it’s not jungle in any case. However, whatever the

source, vibrations started suggesting in late 2016 that a stealth takeover of a delisted ASX entity called Vantage Goldfields was being contemplated. This ill-starred entity (a Galane specialty – as it is ill-starred itself) was delisted from the ASX in late 2014 through a strange selective capital return to shareholders which left a core group of pre-existing shareholders in what was now a delisted entity.



Galane initially used bulletin board sock-puppets to claim “nothing to do with us” but a glance at a map in the company’s April 2016 presentation (above) shows that Vantage Gold’s holdings are highlighted in a map despite the fact that they neither border the Galaxy assets nor are they particularly near (over 50kms away).

Vantage’s mining rights cover the Lily Mine and Barbrook Mines Complex (including the Taylors Mine). Its prospecting rights cover some 16,000 ha of greenstone terrain containing known gold deposits and other exploration targets. These mineral rights surround the central core of the Barberton Goldfield where Pan African Resources plc currently produces some 100,000 oz/annum from three mines (Sheba, Fairview, New Consort).

When we refer to Vantage as ill-starred we primarily are referring to the mine accident at the Lily mine and then subsequent collapses, including a fatal sinkhole, which was topped off by the subsidiary going into administration. From what we can gather Galane is not in pursuit of all of Vantage but rather trying to get its hands on the assets in receivership.

The Lily Mine started as an open pit operation in 2000 and continued as such until 2008, when underground operations commenced. An extensive drilling program identified a Mineral Resource of 1.9

million ozs of gold in a shallow wide ore body. The independent Bankable Feasibility Study completed in 2008 identified mineable ore reserves of 0.35 million ozs of gold.

Gold production was quickly ramped up to 25,000 opa with 27,231 ozs produced in 2015. Future production had been estimated at 30,000 ozs per year for the next 11 years.

Unlike most labour-intensive mines in South Africa, the Lily Mine was a fully mechanised operation employing some 500 skilled and semi-skilled personnel. This is possible because of the wide nature of the ore body which allows large trackless mining machinery to be utilized underground.

Virtually the entire labour force was sourced from the local community and most workers resided within 20 km of the mine. The labour force is unionised and AMCU has 100% representation at the semi-skilled and unskilled level. There has, according to Vantage, long been a good working relationship between management and the union.

The underground ore (approximately 30,000 tonnes per month when functioning) was hauled to the Central Metallurgical Complex (CMC) for processing. The processing plant is a conventional gold process using crushing, milling, CIP and gold recovery to produce bullion bars. Gold was transported by helicopter to Rand Refinery in Germiston for sale.

The Disaster

On 5 February 2016 a *force majeure* event occurred at the Lily Mine forming a massive sinkhole. It is thought that a portion of the crown pillar on 4 Level failed causing a collapse which occurred at the upper western portion of the mine and adjacent to the main entrance to the mine. All employees working underground at the time of the incident were evacuated according to normal mine safety procedures, however three surface employees were buried in the sinkhole (pictured at right) and are still missing.



Mine Rescue Services were deployed and the employees of Vantage's subsidiary, with the assistance of the proto teams, spent the next eight days in a desperate

attempt to rescue the missing employees. Rescue operations were conducted from the emergency outlet shaft but were suspended when ground conditions were declared unsafe. A new rescue hole was drilled in an attempt to provide a safer second outlet. A decision was later made to permanently suspend rescue operations in the interest of safety.

A comprehensive assessment of the entire mine was undertaken and, given that the main entrance to the mine was totally inaccessible, the mine came to a complete standstill and thus was unable to access its ore reserves. This state of things is what forced the operating subsidiary into administration in April of 2016.

In September 2016 the receivers issued a press release stating that, after a frustrated inspection attempt of the state of the underground workings, a collective decision was made, between Mine Management, the Union and Mine Rescue Services to abort the attempts to inspect the localised geological conditions underground. A plan to develop a new decline was proposed. This was to be sited 400m from the disturbed area and, according to the receiver, represents the best option to access the underground workings safely. Plans to implement this were said to remain on track. In the short term some reworking of old mine dumps was going on, but the vast bulk of employees had departed.

In October the receivers stated that they were "... currently engaged with discussions with four potential investors whom wish to acquire a stake in the Vantage Goldfields Group. Furthermore, alternative means of funding the decline have been identified and these are being considered.

Investors require that their identities remain confidential.

A funder has agreed to fund the full amount of USD15 million to reopen the mine by way of a streaming agreement. Reserve bank approval has been acquired by the company to do the transaction. A setback has occurred which is currently being addressed. We cannot commit to timing of the flow of funds".

Here we are nine months later and none of those buyers stepped up to the plate (unless one of them was Galane). Moreover the website has not been updated since that time and there is no corresponding announcement from the Vantage end to corroborate the claim that Galane had made an offer or had signed an LOI.

Things Regulators Miss

The vagueness of the press release on the Vantage "acquisition" would not have flown if it had been made on the ASX. As Vantage has been delisted the only market that got to hear the announcement was the TSX, which is notoriously undemanding of companies with regards to new release clarity. Galane would have been halted in Australia until it elaborated the transaction. In Canada, though, the stock soared to over 10cts as the lemmings crowded on board for the last voyage of the SS Galane.

Needless to say the Exchange did not query the company's announcement or ask for elaboration.

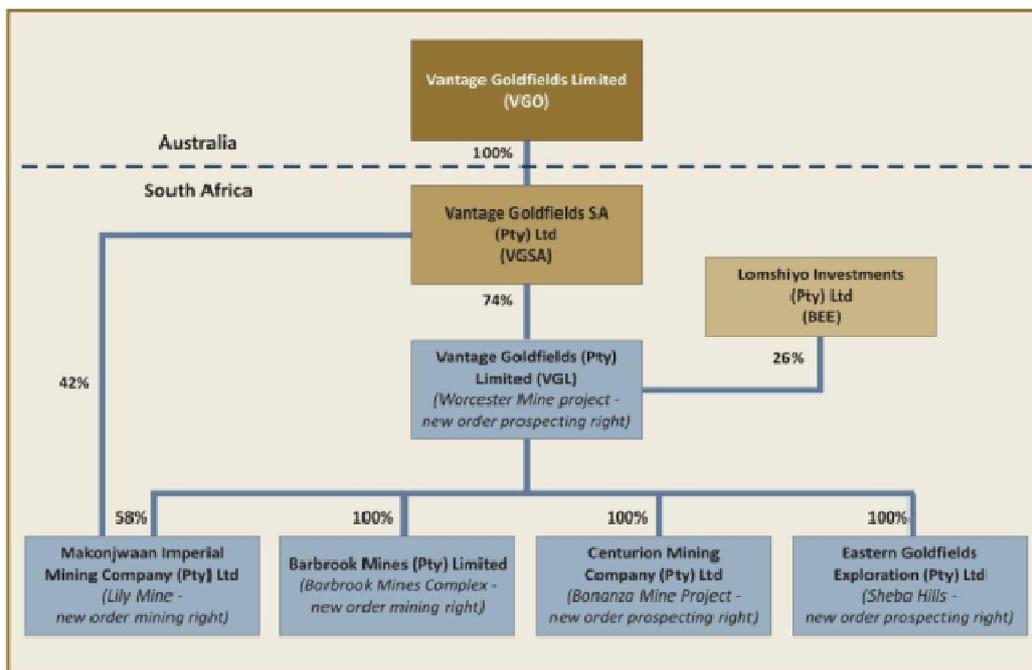
The problems at Galane are threefold. Obviously management is dire, secondly the auditors have rather glibly offered *going concern* assurances that would take anyone else a lot of derring-do to sign and

finally the TSX has allowed the company to drive a truck through news release rules by making an announcement that is not only almost empty of detail, but one that also is highly illogical. Neither has it pressured the company for clarification now that the LOI expiry date has passed.

The announcement said: "Galane Gold Ltd. has entered into a letter of intent (LOI) for the acquisition of all of the outstanding shares of Vantage Goldfields Ltd., a gold mining company with operations in the Mpumalanga province of South Africa.

The LOI establishes the terms of the acquisition as between the parties and is expected to be followed by the execution of a binding acquisition agreement setting forth the detailed terms of the acquisition and containing conditions customary in transactions of this nature, including completion of satisfactory legal and technical due diligence, delivery by Vantage of a National Instrument 43-101 technical report, and receipt of all other necessary regulatory or third party approvals, including the approval of the TSX Venture Exchange and approval of the business rescue practitioner according to applicable legislation in South Africa. The final structure of the acquisition will be determined by Galane and Vantage to accommodate various legal, tax and accounting considerations. The LOI is not binding (other than certain provisions, including exclusivity obligations) and may be terminated by, among other things, mutual consent or if the acquisition agreement and related transaction documents have not been entered into by June 16, 2017. Further details regarding the acquisition, including the consideration to be paid for the outstanding Vantage shares, shall be provided in connection with the announcement of the signing of the acquisition agreement".

Below can be seen the current corporate structure of Vantage.



So this begs a number of questions. What is being taken over here? The subsidiary in South Africa that is in administration, or the whole delisted entity in Australia?

Who has signed the LOI? The board of Vantage? What say do Vantage's shareholders have in this matter? How is it being taken over? Cash? Shares? We have not heard of a liquidator allowing a company in its charge to be acquired for stock alone. But as Galane has no cash how can it make a cash bid? How can a "business rescue practitioner" allow its charge to pass to a company that has strongly negative cashflow to acquire one that is similarly stricken as it gives no assurance to creditors that they will be paid back? We should remind the administrator that the "acquirer" is itself subject to several debt moratoriums having been unable to pay back Samsung and the Government of Botswana.

Latest Results

It becomes tiresome, quarter after quarter, to say that just when you thought the bottom had been reached that things got worse yet again. We took the company's utterances in the December results on likely production for FY17 and then discounted them slightly. We should have discounted them massively in light of the exceptionally poor Q1 results. We might also note that when December results were announced the company's management must already have known how bad Q1 would be as that quarter's end was long past. Therefore the guidance on production was frankly deceptive. The company doesn't seem to think guidance is to manage investor expectations, but rather to manage the stock price in the short term.

The latest quarter was the worst since early 2015 in terms of topline revenues and the worst in memory in terms of bottom line. The loss for the quarter was \$4.26mn. Most notable was the soaring mining costs which yielded the largest gross loss since 2015. Considering that the company sold more gold than it produced this is even more damning. Something is seriously amiss in the cash costs at Tau for such a result to come through at this point. Production in ounces falling to the lowest level in recent memory signals that Tau is not working out as previously signaled. Again this is something that was known when the post-facto production projections were made in the December MD&A.

Our projections for FY17 are shown on the table on the following page. We do not make estimates beyond that as frankly the current situation is unsustainable. We feel we are still being generous with the number of ounces likely to be produced. All the omens are for significantly less. The company cannot sell more ounces than it produces in every quarter of FY17!

The bottom line is estimated at a truly disastrous loss of \$8.8mn. The company does not have the cash or prospects to raise money to deal with such negative free cashflow. There is insufficient funds to service debt, sustain operations through losses, maintain Galaxy in limbo AND get the Lily mine out of its quagmire of misery (while satisfying its extant creditors). To say the company is biting off more than it can chew is a severe understatement.

Galane Gold													
In Millions of USD													
	FY17e	1Q17	FY16	4Q16	3Q16	2Q16	1Q16	FY15	4Q15	3Q15	3Q15	1Q15	FY14
Mine Revenue	36.80	6.73	32.66	7.58	8.40	9.34	7.35	26.23	6.76	8.533	5.173	5.76	40.46
Cost of Mine Revenue	38.70	9.26	33.97	9.30	8.39	8.12	8.16	34.45	11.04	8.565	7.744	7.10	35.98
Gross Profit	-1.90	-2.53	-1.31	-1.72	0.01	1.22	-0.82	-8.22	-4.28	-0.032	-2.571	-1.34	4.49
Selling/General/Admin. Expenses	1.90	0.49	2.10	0.48	0.64	0.47	0.51	2.26	0.62	0.516	0.547	0.59	2.51
Exploration	0.05	0.034	0.026	0.01	0.006	0.007	0.007	0.115	0.01	0.029	0.045	0.036	0.12
Depreciation/Amortisation	-	-	-	-	-	-	-	-	-	-	-	-	-
Interest Expense (Income)	2.25	0.49	0.86	0.53	0.23	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	0.00
Forex costs (gain)	1.50	0.41	1.71	0.33	0.91	0.00	0.47	-3.02	-2.52	-0.38	0.01	-0.13	-
Other Operating Expenses	1.23	0.31	0.66	-0.01	-0.197	0.421	0.45	0.245	-0.02	0.271	-0.005	0.00	0.56
Total Operating Expense	45.63	10.99	39.32	10.62	9.98	9.24	9.49	34.74	9.64	9.17	8.48	7.45	38.58
Operating Income	-8.83	-4.26	-6.66	-3.04	-1.58	0.10	-2.14	-8.51	-2.88	-0.64	-3.31	-1.69	1.88
Gain (Loss) on Sale of Assets	0	0	0	0	0	0	0	0	0	0	0	0	0
Income Before Tax	-8.83	-4.26	-6.66	-3.04	-1.59	0.10	-2.14	-8.51	-2.88	-0.64	-3.31	-1.69	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	0.00
Post- Tax Income	-8.83	-4.26	-6.66	-3.04	-1.59	0.10	-2.14	-8.51	-2.88	-0.64	-3.31	-1.69	1.88
Diluted Weighted Average Shares	142.63	145.732	117.59	142.625	142.618	112.065	71.314	54.90	53.4	52.837	52.823	52.82	54.584
Diluted EPS	-0.062	-0.029	-0.057	-0.021	-0.011	0.001	-0.030	-0.155	-0.054	-0.012	-0.063	-0.032	0.034
Estimated Av. Au Price	\$1,275		\$1,247	\$1,204	\$1,328	\$1,260		\$1,148					\$1,190
Ounces Au produced	32,000	4,298	26,783	6,857	6,243	7,855	5,828	24,321	6,825	7,637	4,829	5,030	30,791
Ounces Au sold		5,531	26,188	6,293	6,326	7,378	6,191	24,205	6,484	7,483	5,098	5,140	

Conclusion

Is it even possible to double down in a game of Russian Roulette? Seemingly so if Galane Gold is any indicator. After having first failed dismally with its stillborn Galaxy mine reboot it has now gone in pursuit of the disastrous (literally) owner of the Lily mine.

Seeing that the company had plunged to its worst loss in ages, mothballed its nascent South African operation before they had even started production and seemingly does not have enough cash or cashflow to meet its imminent debt repayment obligations we figured that the rumoured acquisition of Vantage Goldfields (the benighted, delisted from ASX, South African player with its subsidiary in administration after a mine disaster) was cast to the trash-can of history. Alas, we hadn't counted on the desperate move of a gambler facing the bitter end that then doubles down and the day after our note the company announced some sort of "acquisition" of Vantage.

With the so-recent example of the Galaxy debacle (mothballed before it was reopened) then how can this company be regarded as a competent acquirer/operator for a mine (Vantage's Lily mine) that was itself shut after a tragic sinkhole incident that literally swallowed the mine's admin hut and the staff working therein. The one sign of hope is that the deadline for the Vantage LOI has passed on the 16th of June and as at the close of business on the 19th no update had been given. This is the usual contempt for keeping the market fully informed and so no surprise but neither is it any surprise that a company with no money was essentially unable to make an acquisition.

The long suffering shareholders/creditors of Vantage may have escaped jumping out of the frying pan into the fire. As for Galane's shareholders... well they were warned..

We reiterate our **Short** position in Galane Gold in the Model Mining Portfolio and we take this opportunity to lower our 12-month target price of from CAD\$0.03 to CAD\$0.01.

Tuesday, June 20, 2017



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