Tuesday, May 23, 2017

HALLGARTEN & COMPANY

Results Note

Christopher Ecclestone
cecclestone@hallgartenco.com

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

Key Metrics		
Price (CAD)	$ 0.07	
12-Month Target Price (CAD)	$ 0.03	
Downside to Target	-57%	
High-low (12 mth)	$0.04 - $0.19	
Market Cap (CAD mn)	$ 9.98	
Shares Outstanding (millions)	142.6	
Fully diluted (millions)	162.1	
	2016	**2017e**
Consensus EPS		n/a
Hallgarten EPS (est.)		($0.048)
Actual EPS	($0.057)	
P/E	n/a	n/a

Galane Gold

SNAFU

- + Company continues squeezing some residual production out of its Botswanan assets
- + Investors relieved that yet another purchase of a troubled South African mining asset has been stymied
- ✘ Results tumbled in the December quarter to their largest negative of any quarter in FY16 with a loss of over $3mn
- ✘ Gold price has entered a holding pattern and doesn't offer the company an "out" from its miseries
- ✘ The debt mountain is already having cashflow consequences as delayed payments from previous years kicked in from October 2016 onwards
- ✘ 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

Galaxy – In Galane's Own Words

We have got into the habit of quoting the company's own words because one usually need no more than these to realise something is wrong. Minimal extra spin is needed.

The December quarter results said: "*The Company announced in January 2017 that at the current stage the Galaxy Property does not generate positive cash flows and further capital expenditures are required to complete the full commissioning. The Company is committed to fund the commissioning and subsidize operations at the Galaxy Property from cash flows generated from the Company's Mupane mine. Mupane continues to generate positive operating cash flows; however at the current gold price it is insufficient to fully fund commissioning at the Galaxy Property. With the decline in gold price in November 2016 and the continued uncertainty of the price of gold, management of the Company has decided to be prudent and delay full commissioning at the Galaxy Property until the Company has sufficient funds available.*

The Company will continue to review this decision and work has already commenced on an expansion plan to take annual production up to 60,000 ounces of gold. It is currently envisaged that the Company will commence a desktop study first, the results of which will then be used to support a pre-feasibility study to be completed within two years".

For starters it does not surprise that it does not generate positive cashflow as it isn't producing. If it did we would be even more surprised.

The company is committed to "subsidise operations" which means run at a loss. So the mine is not going to be fully commissioned, does this mean it will be partially commissioned? We suspect not. This is a bit like being “a bit pregnant”, the mine is either commissioned or it’s not. Anything else is mere sophistry.

What does “commenced a plan to take annual production up to 60,000 ozs” mean when annual production is not even one ounce? A PFS? At $3-5mn for a PFS, how will that be paid for? Particularly when almost nothing is being spent on exploration currently?

The Cashflow Trap

In Q4 2016, working capital decreased by $5mn from Q3 2016. The decrease in working capital was mainly due to the following movements in total current liabilities and cash balance:

- A decrease in the cash balance of $1.2 million as a result of; cash flow from operating activities of $2 million; Galaxy capital costs of $2.2 million; Tau underground development costs of $0.6 million and repayment of financing facilities of $0.9 million
- A decrease in ore stockpiles of $1.3 million due to processing of the low grade stockpiles
- An increase in prepayments of $0.2 million in relation to orders placed at Galaxy for the capital project.
- An increase in trade payables of $1.8 million due to foreign exchange revaluation of South African creditors and new creditors as part of the Galaxy capital project
- An increase of $1.2 million in current liabilities in relation to the secured Mupane facility and deferred royalties.

Once again announcement of the quarterly results was left to the 11th hour for reporting. We could see now why the company did not want these numbers in circulation any earlier than they are legally obliged to release them as a perilous confidence house of cards is built upon the premise that the trend has turned for the better. This is where the Galane story has gone awry:

- South African expansion was being funded out of cashflow, investors believed the company when it said cashflow was rising, which as we have seen it is not

- If there is not enough cashflow to sustain the stalled Galaxy Mine then management will need to tap shareholders

- Even worse though, investors had been told that the company can both fund expansion AND meet the resurgent debt repayment schedule that reactivated from early Q4 of 2016

- With losses on the rise and gold lacking upward mobility (and production in Botswana clearly past its peak) the company is staring at a cashflow crunch that requires either a financing, stopping mine development or a further debt restructuring/moratorium

- Any of these three outcomes has the potential to knock the share price closer to our three cent target price or even lower

The company is due to repay the remaining balance of the Samsung financing facility of $2mn and commence the repayment of deferred royalties amounting to $2.9mn during FY17. Where will these funds come from?

Guidance

We note that guidance only pertains to production and as such only pertains to Botswana. Clearly the financial outlook is not something they want to dwell upon.

The MD&A for the December quarter commented that (our take in red):

- Tau Underground – It is estimated that the company will process approximately 400,000 tonnes at an average grade of 2.6 g/t. While developing underground the company intends to continue exploration to attempt to confirm the extension of the Tau mineralised body at depth. This is somewhat ironic as recent quarter's accounts have shown minimal expenditure on exploration, a mere $26,000 in FY16 compared to $115,000 in the preceding FY. The metrics above imply production of around 32,000 ozs. Better than 2016, but we are not factoring in the usual problems that seem to bedevil this company is achieving stated goals. What can go wrong will go wrong.

- Low Grade Stockpiles – the company will process approximately 380,000 tonnes of low grade stockpile at an average grade of 0.78 g/t, which is located at the run-of-mine pad at the processing plant and at Golden Eagle. Once the stockpiles are gone, they are gone. The production from this source might in the best of worlds be only 9,200 ozs if the above can be believed.

- Tekwane – the company will continue to selectively mine the high grade areas and will use a screening plant at the mine site to reduce the tonnage and increase the potential grade to be delivered to the plant. The company is planning to process approximately 30,000 tonnes at an average grade of 1.2 g/t. Hmmm. High grading… Why? The quantities being talked of here amount to only 1,100 ounces.

Latest Results

We are not buying it that the problems of the company stem from a decline in the gold price in 4Q16. Sorry, not persuasive. This company was loss-making and over-extended before whatever "decline" there might have been in the gold price.

Cashflows are dire. For the year ended December 31, 2016, the company incurred a net loss of $6.7 million, with operating activities generating a $4.7mn cash inflow. However, during the year working capital deteriorated by $5.7 million to a deficiency of $8.5mn (in 2015 it was negative $2.8 million). At December 31, 2016, the company had unrestricted cash of $0.8 million and current assets of $9.1mn.

The company's small net result for the June quarter turned out to be a flash in the pan with the third quarter showing a plunge to a loss of $1.59mn and then the fourth quarter getting even worse. This company is the only one we know who takes shelter in the claim that gold is weak.

Galane Gold

In Millions of USD

	FY17e	FY16	4Q16	3Q16	2Q16	1Q16	FY15	4Q15	3Q15	3Q15	1Q15	FY14	FY13
Mine Revenue	40.80	32.66	7.58	8.40	9.34	7.35	26.23	6.76	8.533	5.173	5.76	40.46	53.82
Cost of Mine Revenue	40.76	33.97	9.30	8.39	8.12	8.16	34.45	11.04	8.565	7.744	7.10	35.98	60.28
Gross Profit	0.04	-1.31	-1.72	0.01	1.22	-0.82	-8.22	-4.28	-0.032	-2.571	-1.34	4.49	-6.46
Selling/General/Admin. Expenses	1.90	2.10	0.48	0.64	0.47	0.51	2.26	0.62	0.516	0.547	0.59	2.51	2.81
Exploration	0.05	0.026	0.01	0.006	0.007	0.007	0.115	0.01	0.029	0.045	0.036	0.12	0.17
Depreciation/Amortisation	-	-				-	-	-	-	-	-	-	-
Interest Expense (Income)	2.25	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	17.82
Forex costs (gain)	1.50	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	0.66	-0.01	-0.197	0.421	0.45	0.245	-0.02	0.271	-0.005	0.00	0.56	1.08
Total Operating Expense	47.69	39.32	10.62	9.98	9.24	9.49	34.74	9.64	9.17	8.48	7.45	38.58	82.15
Operating Income	-6.89	-6.66	-3.04	-1.58	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	0	0.02
Income Before Tax	-6.89	-6.66	-3.04	-1.59	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	0.00	0.00	1.81
Post- Tax Income	-6.89	-6.66	-3.04	-1.59	0.10	-2.14	-8.51	-2.88	-0.64	-3.31	-1.69	1.88	-28.78
Diluted Weighted Average Shares	142.63	117.59	142.625	142.618	112.065	71.314	54.90	53.4	52.837	52.823	52.82	54.584	50.36
Diluted EPS	-0.048	-0.057	-0.021	-0.011	0.001	-0.030	-0.155	-0.054	-0.012	-0.063	-0.032	0.034	-0.571
Estimated Av. Au Price	$1,275	$1,247	$1,204	$1,328	$1,260		$1,148					$1,190	
Ounces Au produced	32,000	26,783	6,857	6,243	7,855	5,828	24,321	6,825	7,637	4,829	5,030	30,791	31,586
Ounces Au sold		26,188	6,293	6,326	7,378	6,191	24,205	6,484	7,483	5,098	5,140		

Even our bearish utterances proved to be insufficiently negative. Our earnings model had shown a loss in the fourth quarter of $1.54mn with the caveat that "it could actually go higher" and in reality it was double our projection with a $3mn loss. In fact the loss per share for FY16 was roughly equivalent to the current share price.

We have every generously conceded that the company might produce 32,000 ozs in 2017 but this still produces a loss of nearly $6.9mn, which is actually larger than the loss in FY16.

Conclusion

The roaring waterfall of Galane's Niagara draws ever nearer. Normally one might say fasten your seatbelts it going to be a bumpy ride but in this case we would recommend checking one's life insurance policy. The combination of feckless over-ambitious management with excursions into known troubled mines has proven to be a toxic mix for shareholders. Moreover the poor reputation of the company has meant it has been unable to do any financings in what has been a reasonably good marketing for gold producers to raise money. Word has gotten around….

The debt issue is the most critical factor now. In mid-2016 the company told markets that it was in good shape to meet the resumption of a fairly hefty repayment (and interest) schedule from the beginning of the fourth quarter of that year. Then the gold price fell, its production slipped, its revenues tumbled and problems ensued at Galaxy (raising costs of reviving that out of "cashflow" and then stalling). This raised questions now about the potential for a cash-flow crisis. Now we know the answer as the cash-flow crunch is here.

We repeat our "run to the lifeboats" view of this story and we reiterate our **Short** position in Galane Gold in the Model Mining Portfolio and reiterate our 12-month target price of CAD$0.03 (or lower).

CA:GG Daily
5/19/17
0.20
0.15
0.10
0.05
0.00
Volume
©BigCharts.com
8
6
4
2
0
Millions
Jun
Jul
Aug
Sep
Oct
Nov
Dec
17
Feb
Mar
Apr
May

Important disclosures

I, Christopher Ecclestone, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Hallgarten's Equity Research rating system consists of LONG, SHORT and NEUTRAL recommendations. LONG suggests capital appreciation to our target price during the next twelve months, while SHORT suggests capital depreciation to our target price during the next twelve months. NEUTRAL denotes a stock that is not likely to provide outstanding performance in either direction during the next twelve months, or it is a stock that we do not wish to place a rating on at the present time. Information contained herein is based on sources that we believe to be reliable, but we do not guarantee their accuracy. Prices and opinions concerning the composition of market sectors included in this report reflect the judgments of this date and are subject to change without notice. This report is for information purposes only and is not intended as an offer to sell or as a solicitation to buy securities.

Hallgarten & Company or persons associated do not own securities of the securities described herein and may not make purchases or sales within one month, before or after, the publication of this report. Hallgarten policy does not permit any analyst to own shares in any company that he/she covers. Additional information is available upon request.

Web access at:

Research: www.hallgartenco.com

60 Madison Ave, 6th Floor, New York, NY, 10010