

HALLGARTEN & COMPANY

Results Note

Christopher Ecclestone
cecclstone@hallgartenco.com

Galane Gold (TSX-V: GG, OTCQB: GGGOF)
Strategy: SHORT

Key Metrics				
Price (CAD)	\$	0.050		
12-Month Target Price (CAD)	\$	0.03		
Downside to Target		-40%		
High-low (12 mth)		\$0.045 - \$0.07		
Market Cap (CAD mn)	\$	10.04		
Shares Outstanding (millions)		200.8		
Fully diluted (millions)		269.4		
		2017	2018e	2019e
Consensus EPS			n/a	n/a
Hallgarten EPS (est.)			(\$0.015)	(\$0.015)
Actual EPS		(\$0.023)		
P/E		n/a	n/a	n/a

Galane Gold

The Crushing Debt Burden

- + Positive results reported, albeit fleetingly, for 2Q18
- + Some US\$23.1 million in 1H18 revenue, at an average combined Au/Ag price of \$1,295 per ounce with earnings from mining operations of \$2.5 million
- + Sale of 17,821 ounces of gold plus incidental silver in 1H18
- + The debt with Samsung has finally been paid off
- + Supposedly the Galaxy Mine In South Africa will be revived in 2018
- + A financing for \$2.7mn was announced in recent days
- + Profits come from what looks like high-grading of its last resources in Botswana though recoveries are suffering
- ✗ Collapse of the gold price raises likelihood that results for Q3 and Q4 of FY18 will be in the red
- ✗ Company's credibility has been shredded in the eyes of investors by failure to deliver
- ✗ Lack of clarity on Galaxy Mine, notably no provision of costs or timetable on reopening or details on BEE involvement
- ✗ Almost nothing has been spent on exploration for years now resulting in no new resources or reserves
- ✗ Shuffling of the debt mountain has still left the mountain at the same size as before

Back to Black (Briefly)

To refer to Galane's management as hapless is an understatement. Virtually everything that can go wrong has gone wrong and over the last four years, by our count, only two quarters have been profitable despite the gold price largely being above \$1,200 through that period. Its grand plans for Botswana were reduced to an exercise in high-grading the Tau Underground, with the main legacy being a sizeable largely-unpaid debt to the Botswanan government for overdue royalties. The Galaxy Mine in South Africa was acquired in 2015 and its stop/start operations since have meant it's been a drain rather than a contributor. A mooted run at another disaster-prone mine was narrowly avoided (whether by design or accident is unclear). Meanwhile the company has staggered under a debt mountain owing money to ex-Galaxy holders, the Botswanan government, the Barak group and Samsung. That was then compounded by management, whose name is mud in the eyes of investors that have been burnt by this story over and over again.

The one glimmer of hope was a profitable 2Q18 profit but that was quickly snuffed out by gold going on a slide from mid-June 2018. This augurs ill for the September quarter numbers.

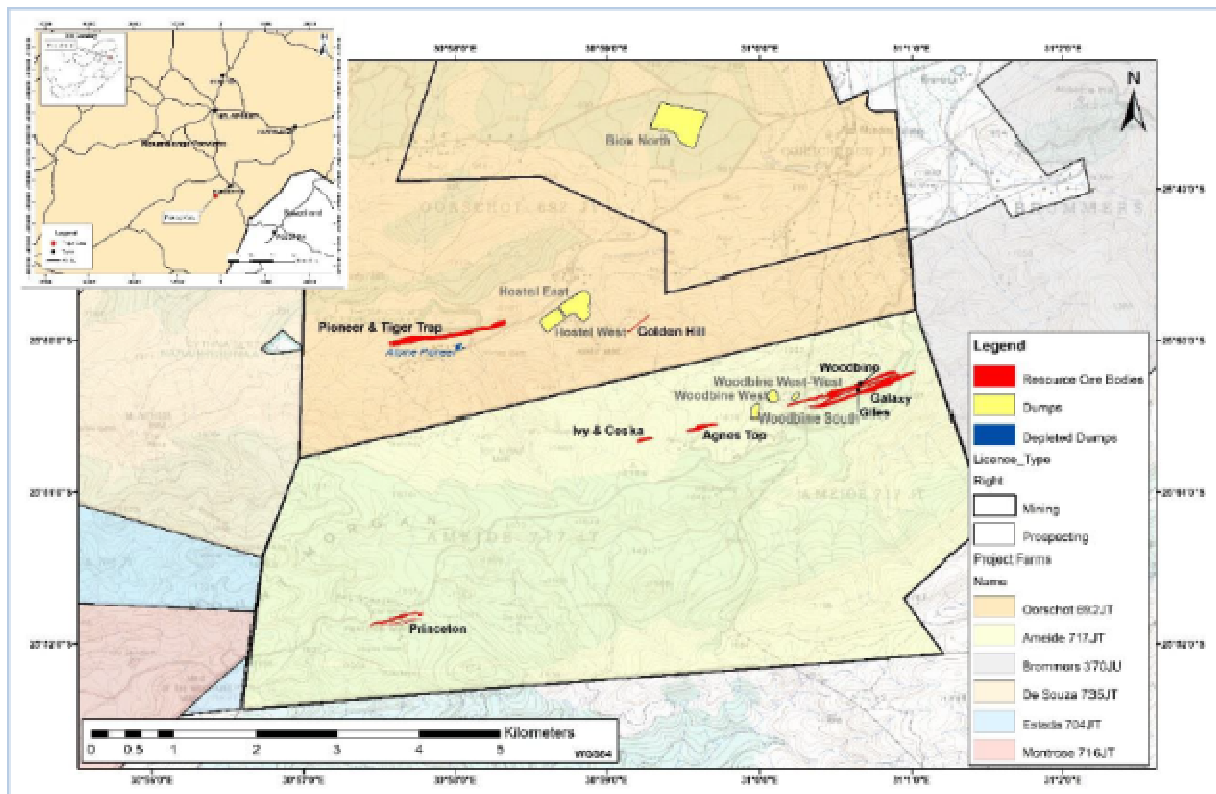
Yet again it holds out the prospect of the Galaxy Mine returning to production if only the funds could be raised. A financing was achieved in recent days but whether it will be enough remains to be seen. We shall look at the results, the debt and the Galaxy aspirations.

Galaxy – Back to the Future

We note that when Galaxy was first mentioned as listing on the Johannesburg Stock Exchange in 2010, it had plans to raise between 250 million-400 million Rand through the listing and one or more private placements. Those funds were to be used to meet a production target of 53,000 tonnes per month by December 2011. Obviously the production target has gone the way of all things and a sale of the entity to Galene for debt/equity of slightly over \$10mn shows a fairly massive destruction of value at Galaxy over the intervening years.

Galaxy Gold's Asset

Galaxy's mining assets are located on the Barberton Greenstone Belt, approximately 10 km to the west of Barberton and 45 km west of the provincial capital of Nelspruit (Mbombela), in the Mpumalanga Province of South Africa. The concession covers an area of 5,863 ha.



The mine comprises 21 east-west trending gold ore bodies and four prospects at 600 – 2,000 m depth. The main targets are the following ore bodies:

- Woodbine, Giles, Galaxy, Golden Hill, Agnes Top, Pioneer & Tiger Trap and Princeton ore bodies
- Ivy and Ceska Shaft Pillars
- Woodbine (East, North and South), Alpine Pioneer, Hostel (East and West) and Biox North historical dumps

Its assets include several historical mining operations, as well as tailings storage facilities comprised of previously mined and processed material.

Gold has been prospected at the Galaxy Gold Mine since the 1880s and Agnes has been exploited as an established mine since 1908. Currently, over 75 historical adits exist within the mining area, as well as tailings storage facilities comprised of previously mined and processed material. To date, the mining assets have produced over one million ounces of gold. For the period 1983 to 2001, production totalled about 351,590 oz gold for the sections Woodbine/Giles, Princeton, Pioneer and Golden Hill.

Galaxy's processing plant was in need of refurbishment and non-functioning at the time Galane arrived on the scene. It consists of a crushing, milling, flotation, thickening, biological oxidation of flotation concentrate (Biox), carbon in leach, elution and tailings disposal set-up designed to treat 16,000 tonnes per month. Statistics in the latest report show that production never exceeded the peak of 12,900 tonnes in the month of October 2010. The average between January 2010 and September 2011 never exceeded 6,000 tpm.

The NI43-101 on Barberton

In January 2016 the company published a mineral resources report for the Galaxy mine. The resource was calculated using US\$ 1,130 per ounce and an exchange rate of ZAR11.70/US\$1.00.

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

Mineral resources were declared at cut-offs of:

- Galaxy, Woodbine, Giles, Golden Hill, Princeton, Pioneer & Tiger Trap, Ivy shaft Pillar, Ivy to Agnes 3-11 Level = 1.8 g/t
- Agnes Top = 1.00 g/t
- Surface dumps = 0.30 g/t

There was also included the Galaxy Gold Mine Mineral Reserve Statement as at 31 August 2015 shown on the following page:

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

The mineral reserve looked like very thin gruel indeed.

The company's executives claimed at the time that the Technical Report shows an all-in sustainable cost of \$688 per ounce at an exchange rate of ZAR11.70/US\$1.00 and a net cash positive position at the end of the first year.

After some refurbishment of the plant and mining facilities an attempt at production was made and quickly abandoned. For some while the company has been claiming it needs around \$5mn to adequately reinitiate the mine and its facilities. The money was not forthcoming and the on-going losses at Tau meant that cashflow alone was not enough to provide impetus to restart Galaxy. Now gold is in the doldrums again (but some funds have been raised) the question arises as to when this pipedream will be achieved.

Beyond all this the company has never provided adequate explanation of how it intends to deal with South Africa's BEE stipulations.

Selling the Farm?

We have long noted the poor history of exploration efforts/expenditure by the company. It is so long since the company announced any "discovery" that we cannot recall when it might have been. Instead of working more intensively its traditional base in Botswana it instead announced in March 2018 that it had agreed an Earn-in Agreement with B2Gold (TSX:BTO) providing an option to indirectly acquire, in tranches, up to 70% of the shares of Southern Cross Exploration and Development (Pty) Ltd., a subsidiary of Galane Gold, which holds two gold prospecting licenses over an aggregate of approximately 520 km² located around the Mupane property (excluding Galane's current operations and mining licenses). B2Gold agreed to carry out exploration on the properties with guidance received from a jointly formed technical committee.

Financing the (Second) Reboot

To effect the Galaxy Mine reboot in early March 2018, Galane announced that it had entered into a loan

agreement with Barak Fund SPC Limited for a \$5,000,000 secured loan facility, for a term ending three years from the date of the first drawdown and bearing interest at a rate of 14% p.a.. In a sort of streaming deal, Galane has committed to pay to Barak, or its nominee, 0.75% of the net proceeds accruing to Galaxy Gold Mining Ltd under an off-take agreement covering the annual gold concentrate production of the Agnes gold mine, after taking into account all attributable logistics and freight costs, State Royalties and value-added tax. Drawdowns on the facility were subject to certain conditions precedent, which the Galane expected to complete by September 2018 (no sign yet that we have seen).

Now for the triumph of hope over experience, assuming the drawdown under the Barak facility, Galane talks of the first production at the Galaxy mine by the end of the first quarter of 2019 and the first phase of the restart of the Galaxy Property to increase the capacity of the processing plant to 30,000 tonnes per month and annual production to over 25,000 ounces of gold at a projected cash cost per ounce of less than \$800. During the implementation of the first phase, Galane is talking of completing a study on the second expansion phase to increase the capacity of the processing plant to 60,000 tonnes per month and decreasing the cash cost per ounce with increased economies of scale. We have heard all this before, so excuse our scepticism.

The Debt Mountain Shifts

The table at the right shows the balance sheet as at the end of 2Q18.

Galane has long labored under a rising mountain of debt. With the brief return to profitability the size of the heap has stopped growing and the latest published accounts show a shift of debt from short-term to long-term but no appreciable change in the sheer size of the debt at US\$31mn between the latest reading at the end of June and the situation nine months previously.

It is interesting to note that Galane's management have never been fazed by this debt mountain and have regularly

Galane Gold - Balance Sheet		
	September End 2017	June End 2018
Current assets:		
Cash	1,756,940	3,685,433
Trade receivables and other current assets	1,357,554	1,705,474
Inventories	5,195,854	4,641,654
	<u>8,310,348</u>	<u>10,032,561</u>
Non-current assets:		
Mining properties	33,197,921	34,387,794
Plant and equipment	2,748,110	1,979,048
Ore stockpiles		
	<u>35,946,031</u>	<u>36,366,842</u>
	<u>44,256,379</u>	<u>46,399,403</u>
Current liabilities:		
Accounts payable and accrued liabilities	9,770,283	10,038,036
Interest-bearing loans and borrowings	10,198,280	1,014,138
	<u>19,968,563</u>	<u>11,052,174</u>
Non-current liabilities:		
Interest-bearing loans and borrowings	6,123,676	13,758,284
Warrants denominated in a foreign currency	154,116	31,309
Restoration and rehabilitation provision	6,060,541	6,416,008
	<u>12,338,333</u>	<u>20,205,601</u>
Shareholders Equity	<u>11,949,483</u>	<u>15,141,628</u>
	<u>44,256,379</u>	<u>46,399,403</u>

taken on more debt to fund adventures such as the Galaxy purchase, which added nothing to revenues but had a significant negative effect on the balance sheet.

It's worth reviewing here the major components of the current debt profile.

The Galaxy Hangover

Several years ago the company issued unsecured debentures to certain Galaxy loan holders and other parties as settlement of amounts previously due on the acquisition of Galaxy in 2015. The current terms of the debentures are as follows:

- Initial principal amount - \$5,650,269
- Interest rate - fixed rate of 4% per annum, compounded annually
- \$2,400,836 of such principal is repayable on November 20, 2019 and is 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.

The Barak Debt

In accordance with an amended and restated debenture agreed to between Galane and a debenture holder in the second quarter of 2018:

- \$3,249,433 of such principal is repayable on November 20, 2021 and is convertible into common shares at a price of Cdn.\$0.15 per share, based on a pre-determined exchange rate
- interest is convertible into common shares, based on a pre-determined exchange rate, at a price equivalent to the greater of Cdn.\$0.15 and the Discounted Market Price at the time of conversion
- Galane has a right to force conversion for the principal where the trading price of the common shares exceeds CAD\$0.15 for 10 consecutive trading days
- the accrued interest to December 31, 2017 becomes payable 7 days after the Galane first draws down on the loan facility
- commencing January 1, 2018, interest for a calendar year will be due and payable on March 31 of the subsequent year, with the first such payment being due on March 31, 2019

The Botswanan Debt

The Government of Botswana has shown the patience of Job in its dealings with Galane on the tardy

payment of royalties owing. These royalties were all recorded as current liabilities at December 31, 2017, however on March 19, 2018 an agreement was reached with the government regarding royalties payable on the sale of gold and subsequent repayment thereof under the following terms:

- \$8,398,709 of royalties deferred to December 2017 will commence repayment in March 2018 over 34 months as follows:
 - principal repayments of \$21,593 per month for ten months commencing March 2018,
 - principal repayments of \$101,593 per month for 12 months commencing January 2019
 - the remaining balance to be repaid in 12 equal monthly payments commencing January 2020
- interest to be charged at Bank of Botswana commercial bank prime lending rate plus 5%, applied on a simple interest basis, equating to \$28,407 per month over the 34 month repayment period
- the deferral amount is unsecured

The Traxys Debt

In early July 2018, it was announced that had entered into an agreement with Traxys Europe SA to replace the existing 4% unsecured convertible debenture in the principal amount of US\$3,249,433. This was issued to Traxys on March 29, 2016 and is convertible into common shares of Galane. Under the terms of the new debenture, the conversion price of the principal amount of the debenture has been reduced from CDN\$0.58 to CDN\$0.15 per common Share and the maturity date has been extended from November 20, 2019 to November 20, 2021.

The Latest Financing

In early October the company announced it had closed a non-brokered private placement of 54 million units at a price of five cents per unit for aggregate gross proceeds of \$2.7mn. Some are claiming that this financing gets the company over the line for the amount required to reboot the Galaxy Mine. Having heard this claim before our response is “seeing is believing”.

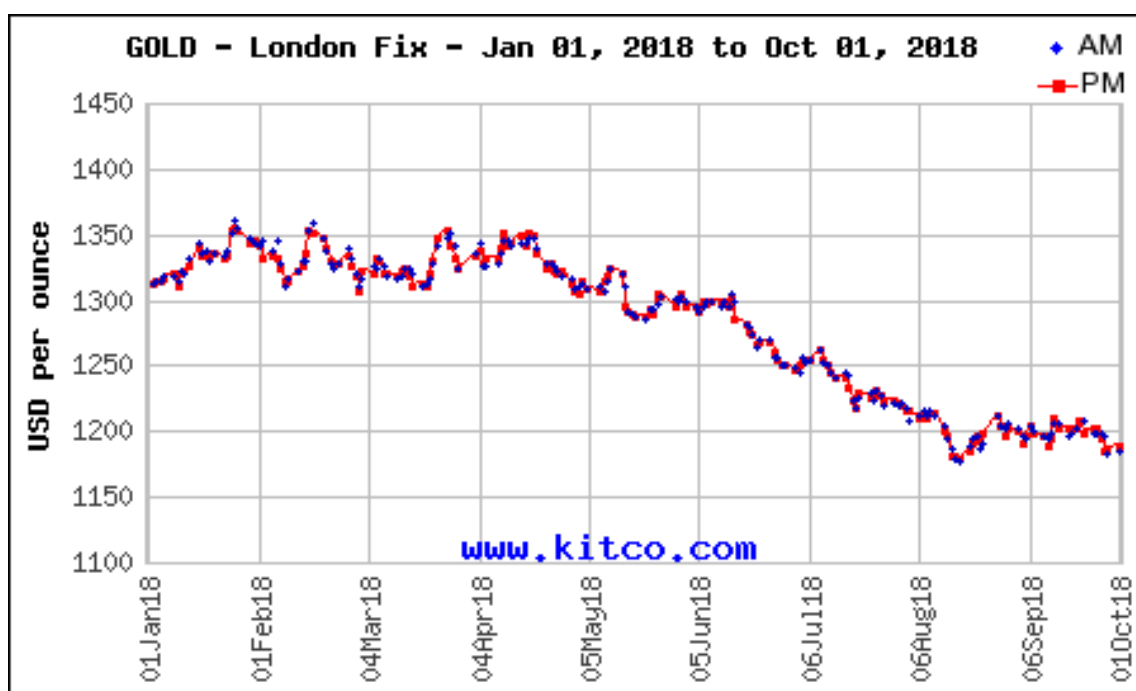
Each unit consisted of one common share of the company and one common share purchase warrant, with each warrant entitling the holder thereof to acquire one common share at an exercise price of five cents until Oct. 1, 2020. The expiry date of the warrants can be accelerated by the company to the date that is 10 business days after the date where the closing price of the common shares on the TSX Venture Exchange is higher than 20 cents for 10 consecutive trading days, provided such trading days occur four months and one day after the issuance of the warrants.

As previously announced, certain directors and officers of the company purchased 10,563,000 units for aggregate gross proceeds of \$528,150. The issuance of these units was considered to be a related party transaction within the meaning of Multilateral Instrument 61-101 -- Protection of Minority Security Holders in Special Transactions.

Gold Price Woes

Some might think that Galane’s management can never cop a break. However, they are largely buffeted by storms of their own making, except when it comes to the gold price. However if the company had a decent margin (i.e. a low Opex) then it would be able to weather the storms caused by gold’s fluctuations.

The latest quarter of positive results relates to the last decent quarter before gold started to fade rapidly in June. The chart below shows the progression of the price during 2018. The price had hit \$1250 per oz by the end of June and has largely averaged \$1200 (with dips lower) during the current quarter. This implies a decline of at least \$1mn in revenues from gold sales during 3Q18 and possibly more.



The table on the following page displays the recent progression of earnings at the company and the outlook for the next two full fiscal years.

The key challenge facing an analyst with Galane is whether to believe what the company says about Galaxy and its potential production. For those of us that have covered this stock over the long we know all too well what happens to management’s predictions in the harsh light of day. Will Galaxy be producing in 2019? How much will it produce? Will it make money on what it produces? Then back at the keystone Botswanan properties. How long can Tau be high-graded? How can Botswanan resources be expanded when virtually nothing is spent on exploration?

Galane Gold											
In Millions of USD											
	FY18e	2Q18	1Q18	FY17	4Q17	3Q17	2Q17	1Q17	FY16	FY15	FY14
Mine Revenue	43.80	13.17	9.91	37.30	10.56	11.80	8.21	6.73	32.66	26.23	40.46
Cost of Mine Revenue	40.50	10.98	9.63	35.56	8.19	9.99	8.13	9.26	33.97	34.45	35.98
Gross Profit	3.30	2.19	0.27	1.74	2.37	1.81	0.09	-2.53	-1.31	-8.22	4.49
Selling/General/Admin. Expenses	2.60	0.65	0.65	1.88	0.35	0.57	0.47	0.49	2.10	2.26	2.51
Exploration	0.20	0.06	0.06	0.21	0.07	0.057	0.05	0.034	0.026	0.115	0.12
Depreciation/Amortisation	-			-				-	-	-	-
Interest Expense (Income)	0.90	0.15	0.15	2.15	0.50	0.63	0.53	0.49	0.86	0.69	-0.58
Unusual Expense (Income)	0.00			0.00	0.00			0.00	0.00	0.00	0.00
Forex costs (gain)	1.20	-1.29	0.60	0.57	0.18	-0.07	0.05	0.41	1.71	-3.02	
Other Operating Expenses	0.86	0.16	0.29	0.23	0.27	-0.655	0.308	0.31	0.66	0.245	0.56
Total Operating Expense	46.26	10.71	11.38	40.60	9.56	10.52	9.54	10.99	39.32	34.74	38.58
Operating Income	-2.46	2.40	-1.47	-3.30	1.00	1.29	-1.33	-4.26	-6.66	-8.51	1.88
Gain (Loss) on Sale of Assets	0	0	0	0	0	0	0	0	0	0	0
Income Before Tax	-2.46	2.40	-1.47	-3.30	1.00	1.29	-1.33	-4.26	-6.66	-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
Post- Tax Income	-2.46	2.40	-1.47	-3.30	1.00	1.29	-1.33	-4.26	-6.66	-8.51	1.88
Diluted Weighted Average Shares	160.00	148.80	146.80	146.41	146.804	146.804	146.285	145.732	117.59	54.90	54.584
Diluted EPS	-0.015	0.016	-0.010	-0.023	0.007	0.009	-0.009	-0.029	-0.057	-0.155	0.034
Estimated Av. Au Price	\$1,200		\$1,280	\$1,275					\$1,247	\$1,148	\$1,190
Ounces Au produced	35,000	10,088	7,649	29,354	8,812	9,535	6,709	4,298	26,783	24,321	30,791
Ounces Au sold	34,700	10,259	7,562	29,896	8,569	9,251	6,545	5,531	26,188	24,205	

We expect lower gold production in the next two quarters to be announced. We expect the last two quarters of FY18 to be slight lossmakers which combined with the loss-making first quarter will result in the company making a loss for the full fiscal year of \$2.46mn or 1.5cts per share on the average number of shares on issue (with this number having blown out in Q4 to nearly 200mn shares on issue due to the latest financing).

Below can be seen a model for FY19 parsed by the various versions. The version on the right is if Galaxy doesn't get into production. The middle column is if it starts production in some way (taken in light of past missteps) and the left column marked ATWHYB (As They Would Have You Believe) is what one might deduce from the information that management is fairy-dusting around the market.

Galane Gold (with Galaxy)			
In Millions of USD			
	FY19e	FY19e	FY19e
	ATWHYB	Galaxy Light	No Galaxy
Mine Revenue	67.66	52.93	39.80
Cost of Mine Revenue	59.80	48.50	37.70
Gross Profit	7.86	4.43	2.10
Selling/General/Admin. Expenses	4.00	3.60	2.50
Exploration	0.50	0.50	0.20
Depreciation/Amortisation	-	-	-
Interest Expense (Income)	2.25	1.80	0.90
Unusual Expense (Income)	0.00	0.00	0.00
Forex costs (gain)	1.20	1.20	1.20
Other Operating Expenses	1.00	0.70	0.40
Total Operating Expense	68.75	56.30	42.90
Operating Income	-1.09	-3.37	-3.10
Gain (Loss) on Sale of Assets	0	0	0
Income Before Tax	-1.09	-3.37	-3.10
Tax	0.00	0.00	0.00
Post- Tax Income	-1.09	-3.37	-3.10
Minorities			
Diluted Weighted Average Shares	201.00	201.00	201.00
Diluted EPS	-0.005	-0.017	-0.015
Estimated Av. Au Price	\$1,250	\$1,250	\$1,250
Ounces Au produced	57,000	44,000	32,000
Ounces Au sold	55,000	31,700	31,700

As per usual, the company still makes a loss despite the greater volume of gold produced.

Risks

The principal risks for a Short position at Galane Gold are:

- Change of management
- Strong uplift in the gold price
- Predatory bid

The two least likely dangers are the second and third. An uplift in gold might happen but as we have seen in the past this doesn't necessarily help Galane's bottom line to improve as it has an extraordinary ability to miss opportunities. A predatory bid is unlikely as the management has a large number of shares and a predator would be better advised to just await the company's demise to pick up the assets. No-one would bid for the whole company to get the Botswanan assets as their minelife is indeterminate but tending towards the short end.

A change of management is unlikely also because the current management is entrenched and they hold a large position emanating from their purchase of the lamgold stake at 1ct per share and then the rights issue at a similar discount. The management group is their own poison pill at Galane Gold.

Conclusion

We find it hard to recall a company that has taken so long to achieve any traction in financing a gold mine reopening, with such a low Capex required. This is an indictment of the low standing and credibility that the company's management has with the investment community. The company is something of a modern equivalent of the medieval leper, wandering the landscape ringing a bell and forced to cry "unclean, unclean" to warn investors of their approach. Now some funds have been dredged up but they are virtually a "widow's mite" and thus force the company to tap a credit line rather than fund the Galaxy Mine re-opening from its own resources. It goes without saying the shares on issue have had yet another massive blowout to nearly 200mn.

Our thesis for metals is for base metals to rebound from their "trade war"-induced slump but there is only slight hope to believe that silver might participate in this rally and no reason at all for gold to do so. Gold has reset \$100 per ounce lower than where it was for most of the last few years and this is bad news for Galane which continually claims its cash cost per ounce is well below \$1,000 and yet can rarely register a profit. The latest downshift ensures that the company shall struggle to remain in the black and that removes any possibility that its reputation with investors might be redeemed.

The *Damoclean* sword of the debt burden still hangs over the company (as if it doesn't have enough problems in its management and the gold price). Any hope that the debt mountain might be chipped at by positive cashflows are dashed now by the gold price's retreat.

With this woeful background we reiterate our **Short** position in Galane Gold in the Model Mining Portfolio with a 12-month target price of CAD\$0.03.

Thursday, October 4, 2018



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.

© 2018 Hallgarten & Company, Ltd. All rights reserved.

Reprints of Hallgarten reports are prohibited without permission.

Web access at:

Research: www.hallgartenco.com

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