



HALLGARTEN & COMPANY

Results Note

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

Key Metrics		
Price (CAD)	\$	0.095
12-Month Target Price (CAD)	\$	0.06
Downside to Target		-37%
High-low (12 mth)		\$0.04 - \$0.13
Market Cap (CAD mn)	\$	19.08
Shares Outstanding (millions)		200.8
Fully diluted (millions)		270.0
	2019	2020e
Consensus EPS		n/a
Hallgarten EPS (est.)		\$0.015
Actual EPS	(\$0.019)	
P/E	n/a	\$ 6.13

Galane Gold

Incompetence Will Out

- + The gold price has rebounded to around \$1,700 per ounce
- + Production has started (again) at Galaxy mine, but minimal production reported for 2019
- + B2Gold reached their investment commitment on the first phase of the earn-in on properties but with no subsequent news of note
- ✗ The brief dawn of profitability in mid-2019 was snuffed out with a tumble to a sizable loss in 4Q19
- ✗ Company is laboring under USD\$35.2mn in debt (\$23mn of which is S/T) with only USD\$2.2mn in the cash on hand
- ✗ Efforts are being made to renegotiate debt settlement, agreed in 2018, with the Botswanan government as royalty payments owed build up again
- ✗ Almost nothing has been spent on exploration for years, resulting in no new resources or reserves

Inflection Delayed?

The year gone by, 2019, was supposed to be the inflection point for Galane Gold. The Galaxy Mine in South Africa would finally come on-stream (again) and the gold price at over \$1600 made for a vision of sunny uplands. The one fly in the ointment was us... continually harking back to past incompetence and SNAFUs at the company. We have been called *Cassandras* as far as this company is concerned. However, history has kept proving us.... right.

With our **Short** call perpetually acting as an albatross around this stock, we thought that maybe we had finally met our match as the company managed to put in two OK quarters in the middle of last year. Then, lo and behold, with its December quarter results (and for the full FY2019) the company managed to yet again snatch failure out of the jaws of victory.

The turnaround was therefore delayed again. But the portents from the South African operation were even feebler than we, with our jaded viewpoint, could have imagined. We felt sure to have lowballed the production but then it came in even lower at a measly 2,905 ozs (and in concentrate to add insult to injury). Nothing was said as to why this disappointing outcome came about.

Long suffering shareholders get no sympathy from us as they have been warned over and over again. In this note we shall look at the latest attempts to browbeat the Botswanan government into offering yet another debt extension and we shall examine the results for FY19 which showing a dismayingly familiar continuation of the negative bottom line that the company has shown since 2014.

Where is Galaxy When you Need It?

On the last page of the results for FY19 is a rather stunning admission to the effect that in the year ended December 31, 2019 all revenues of Galane were earned in the Republic of Botswana. Production of gold from Galaxy was a measly 2905 ozs (in concentrate).

The Ongoing Royalty Problem

The long-term problem at Galane has been that the company's management are debt junkies and don't like paying what is owed. As a result the company has owed large amounts of money for a long time to various parties.

Most embarrassing of all these is the money owed for back royalties to the Botswanan government. The royalty rate is 5% on all gold sales in accordance with the terms of the royalty.

The Government of Botswana royalties were all recorded as current liabilities until early 2018, 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 would commence repayment in March 2018 over 34 months
- principal repayments of \$21,593 per month for ten months commencing March 2018
- principal repayments of \$101,593 per month for 12 months commenced 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 +5%, applied on a simple interest basis, equating to \$28,407 per month over the 34 month repayment period

Royalty Debt Repayments	
Total Owing as at March 2018	8,398,709
Pay in 2018	215,930
Pay in 2019	1,219,116
Pay in 2020	6,963,663

The fourth bullet point is classic Galane. If one calculates it the amount payable is \$580,000 per month, which is nigh on \$1.74mn per quarter.

The problem for the company is that while it must pay back royalties it must also pay royalties on current production. The royalty expense for the year ended December 31, 2019, was \$2.1mn, which was

funded from cash flows from operations, in addition to \$1.6 million repaid from deferred royalties in accordance with the agreement for the repayment of deferred royalties.

The company repaid only US\$200,000 in each of January and February 2020, when it should be repaying \$580,000 per month.

While the deferral amount is unsecured we doubt the company's concessions would be safe from confiscation if it defaults again on the amounts owed as production is in decline and the company could "do a runner". This must be a consideration for B2Gold.

The results for FY19 stated: "While management projects that the current gold price would allow the Company to repay the deferred royalties consistent with the payment schedule agreed with the Government of Botswana, the Company has entered into discussions with the Government of Botswana to reschedule the outstanding balance".

As a result of the current precarious payment situation with the 2020 payments being so steep, all the debt to the government has now migrated back into the Current Liability category.

Recent Results

A look at the company's earnings statement back over the years makes a dismaying reading. It is difficult to find another gold producer that has managed to lose money every year since 2014. Its hefty losses in Q1 and Q4 more than wiped out the moderate profits in the two middle quarters.

It is interesting to note that in every quarter the company sold more ounces than it produced. Quite how this feat was achieved when it did the same thing in FY18 remains a mystery. Essentially the company appears to be living on its fat when it is anything but chubby.

In a rather bizarre turn of phrase the company's FY19 results stated: "The ongoing strength in gold prices and positive operating performance at the Mupane mine have resulted in earnings from mining operations of \$0.8 million in 2019 compared to \$3.0 million in 2018". So the company is attributing the lower earnings to the higher gold price?

In addition, "cash flow generated from operations in 2019 was \$2.9 million, after royalty payments made in the normal course of business, compared to \$4.2 million of cashflow from operations in 2018". So cashflow was down...

The table on the following page shows past earnings and our VERY tentative projections for FY20. We have been proved wrong on even our most bearish projections in the year gone by.

In light of the higher gold price, we are estimating a 50% increase in revenues to around \$62mn. This should push up gross profits (in theory) but the hefty interest costs that the company is now bearing will consume a goodly chunk of the enhanced profitability. Our net revenue estimate is for US\$3.11mn of 1.5cts per share. Time will tell.....

Galane Gold

In Millions of USD

	FY20e	FY19	4Q19	3Q19	2Q19	1Q19	FY18	FY17	FY16	FY15	FY14
Mine Revenue	62.16	41.40	9.04	12.46	11.42	8.48	44.65	37.30	32.66	26.23	40.46
Cost of Mine Revenue	48.70	40.57	9.78	10.89	10.60	9.30	41.68	35.56	33.97	34.45	35.98
Gross Profit	13.46	0.83	-0.74	1.57	0.82	-0.82	2.97	1.74	-1.31	-8.22	4.49
Selling/General/Admin. Expenses	2.65	1.70	0.13	0.68	0.22	0.68	2.98	1.88	2.10	2.26	2.51
Exploration	0.10	0.00	0.00	0.00	0.00	0.00	0.20	0.21	0.026	0.115	0.12
Depreciation/Amortisation								-	-	-	-
Interest Expense (Income)	5.20	2.18	1.26	0.44	0.10	0.38	0.92	2.15	0.86	0.69	-0.58
Unusual Expense (Income)								0.00	0.00	0.00	0.00
Forex costs (gain)	0.65	0.03	0.25	-0.26	-0.08	0.11	-1.63	0.57	1.71	-3.02	
Other Operating Expenses	0.80	0.74	-0.15	0.24	0.41	0.25	0.83	0.23	0.66	0.245	0.56
Total Operating Expense	58.10	45.22	11.27	11.98	11.26	10.72	44.97	40.60	39.32	34.74	38.58
Operating Income	4.06	-3.82	-2.23	0.48	0.16	-2.25	-0.32	-3.30	-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	4.06	-3.82	-2.23	0.48	0.16	-2.25	-0.32	-3.30	-6.66	-8.51	1.88
Tax	0.95	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Post- Tax Income	3.11	-3.82	-2.23	0.48	0.16	-2.25	-0.32	-3.30	-6.66	-8.51	1.88
Diluted Weighted Average Shares	200.80	201.81	201.80	200.80	200.80	200.80	160.27	146.41	117.59	54.90	54.584
Diluted EPS	0.015	-0.019	-0.011	0.002	0.001	-0.011	-0.002	-0.023	-0.057	-0.155	0.034
Estimated Av. Au Price	\$1,680	\$1,378	\$1,580	\$1,460	\$1,305	\$1,291		\$1,275	\$1,247	\$1,148	\$1,190
Ounces Au produced	24,700	30,294	6,839	8,435	8,694	6,326	35,527	29,354	26,783	24,321	30,791
Galaxy concentrate (ozs) 74%	12,300	2,905	2,905								
Ounces Au sold	37,000	30,950	7,097	8,538	8,750	6,565	35,746	29,896	26,188	24,205	

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 has occurred since the middle of 2019 but as we have seen in the past this doesn't necessarily help Galane's bottom line to improve, as management have 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

To paraphrase Britney Spears, "Oops, they did it again". Galane Gold's management has the ability to seize defeat from the jaws of victory over and over again. The management would argue that Galaxy production is in its infancy, but in fact we have been waiting several years since this asset was bought (and there was the abortive initial restart) to see any production numbers and when the initial production numbers came in they were decidedly puny at only 2,905 ozs (in concentrate) in the totality of 2019. Scorecard says "Must try harder".

One might argue that the company is cursed as it has shown an uncanny ability to turn a propitious situation into a debacle. Gold was looking good to great during 2019 and its poor Q1 numbers were followed by an earnings rebound in Q2 and Q3 and then tumbled back into sizeable losses in Q4. However the word "cursed" might imply that the damage was caused by outside forces rather than internal failings. Thus far there has been no *force majeure* in Galane's debacles for they have all been of the management's own making.

So what to believe? The gold price is up and we feel it is destined to remain in profitable territory for efficient and competent miners. Galane's team have almost got to the end of the road in having tried virtually everything they can to trip themselves over, so they now must actually circle back and start making the same mistakes again to destroy their prospects of a consistent return to profitability. Can they? Will they?

Thursday, May 14, 2020

The biggest dangers now appear to be the Botswanan government finally losing patience with the non-payment of royalties, that Tau finally runs out of ore and/or that South Africa massively underwhelms on the production front. All are realistic threats.

Why a Short? The company cannot afford to repay the Botswana government at the agreed rate (short of gold being over \$2,000 an oz). Management has shown a lackadaisical attitude to paying their obligations and as the gold price goes up the royalties owed on current production go up as well. Why the poor of Botswana should subsidise the management of Galane (who have not tightened their own belts) has long eluded us. A sizeable financing (\$6-10mn) will be required to try and ultimately clear the debt burden and that will create yet more dilution and inevitably lower the share price.

In light of the above we reiterate our **SHORT** position in Galane Gold in the Model Mining Portfolio with a 12-month target price of CAD\$0.06.



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