Ten-year Anniversary Special

EXPLORER QUARTERLY CASH UPDATE

Long-term Trends Sneak Preview
Jun 2013 to Mar 2023

IDEAS | PEOPLE | TRUST

FOREWORD

Every quarter since June 2013, BDO has analysed the financial health of the Australian exploration sector based on cash flow data from Appendix 5B reports lodged with the Australian Securities Exchange (ASX) by listed exploration companies.

The June quarter of 2023 marks the 10th year anniversary for our analysis of this data, and over the course of this period, we have had the privilege of witnessing how the sector has grown and evolved against the wider backdrop of the business cycle, capital market movements, geopolitical events and trends in commodity markets.

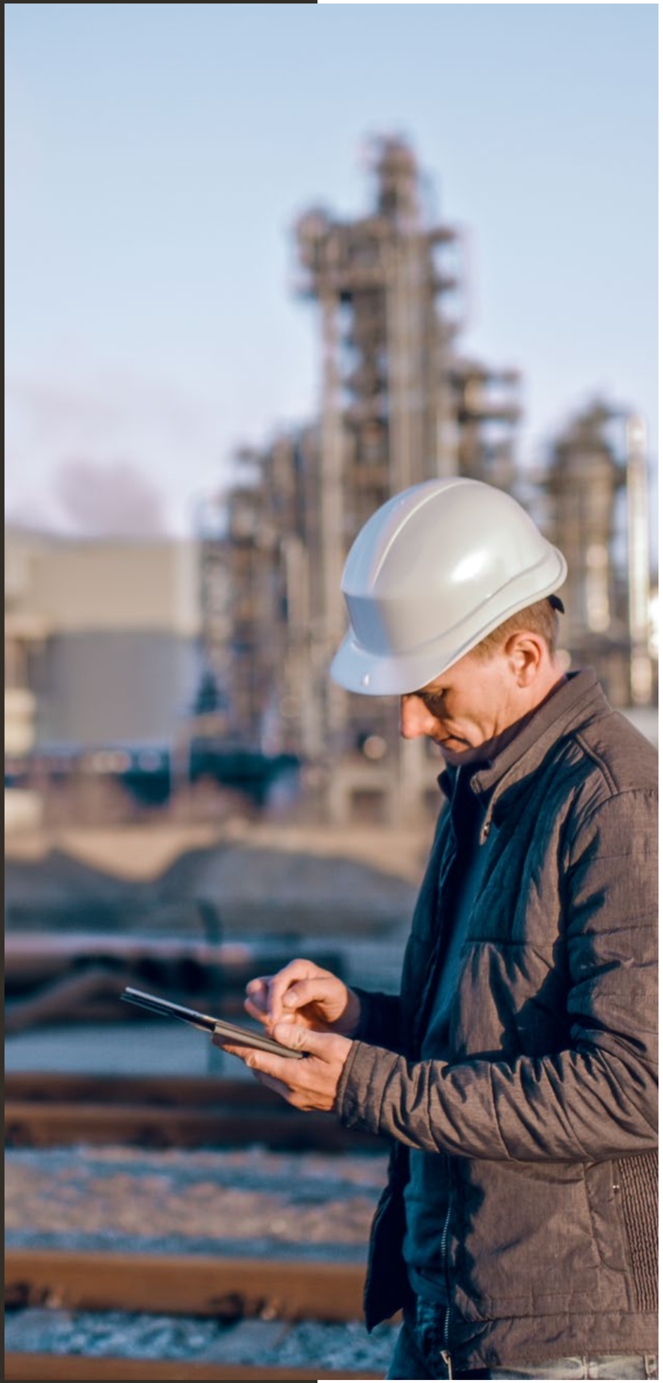
Cash, as we know, is the lifeblood of exploration companies. Our quarterly analysis has always sought to understand how cash is moving in and out of the sector, and aims to answer questions such as, 'how much cash is being raised?', 'by whom?' and 'how is it being spent?'.

When reflecting on the history of Australia's junior exploration sector, I enjoy Paydirt Media's Dominic Piper's quote (in the July 2022 issue of Australia's Paydirt) which describes Australia as having always "*drawn the lucky commodity card*". This relates to Australia's timely abundance of key commodities, such as gold in the 1870s, nickel in the 1960s, iron ore in the 1970s and 2000s, gas in the 2010s and now battery minerals for 2020s and beyond. Indeed, Australia has been dealt a good hand, and the diversified nature of its exploration sector has certainly contributed to the sector's resilience throughout the years.

The Appendix 5B data for the quarter ended 30 June 2023 was lodged by companies on the ASX at the end of July 2023, with our June 2023 report due for release in early September. In anticipation of our June report, I am pleased to present this sneak preview of the long-term trends observed from the June 2013 to the latest March 2023 quarter.

Completing this analysis for the last ten years represents a significant milestone for BDO as a leading expert in the Australian junior exploration space. We celebrate this achievement and are looking to explore more interesting findings and articles based on our ten years of data over the coming months - do keep a look out!

SHERIF ANDRAWES
Partner and BDO's Global and National Head of Natural Resources
Corporate Finance
sherif.andrawes@bdo.com.au
+61 8 6382 4763



NUMBER OF COMPANIES

In June 2013 when we first commenced our analysis, the exploration sector comprised 860 companies lodging an Appendix 5B, which reached a ten-year peak of 865 in the September 2013 quarter. Subsequently, this began to decline, reducing to 814 companies in the December 2014 quarter. At the time, this was driven by a growing number of companies ceasing exploration in light of challenging market conditions, including low demand and low commodity prices.

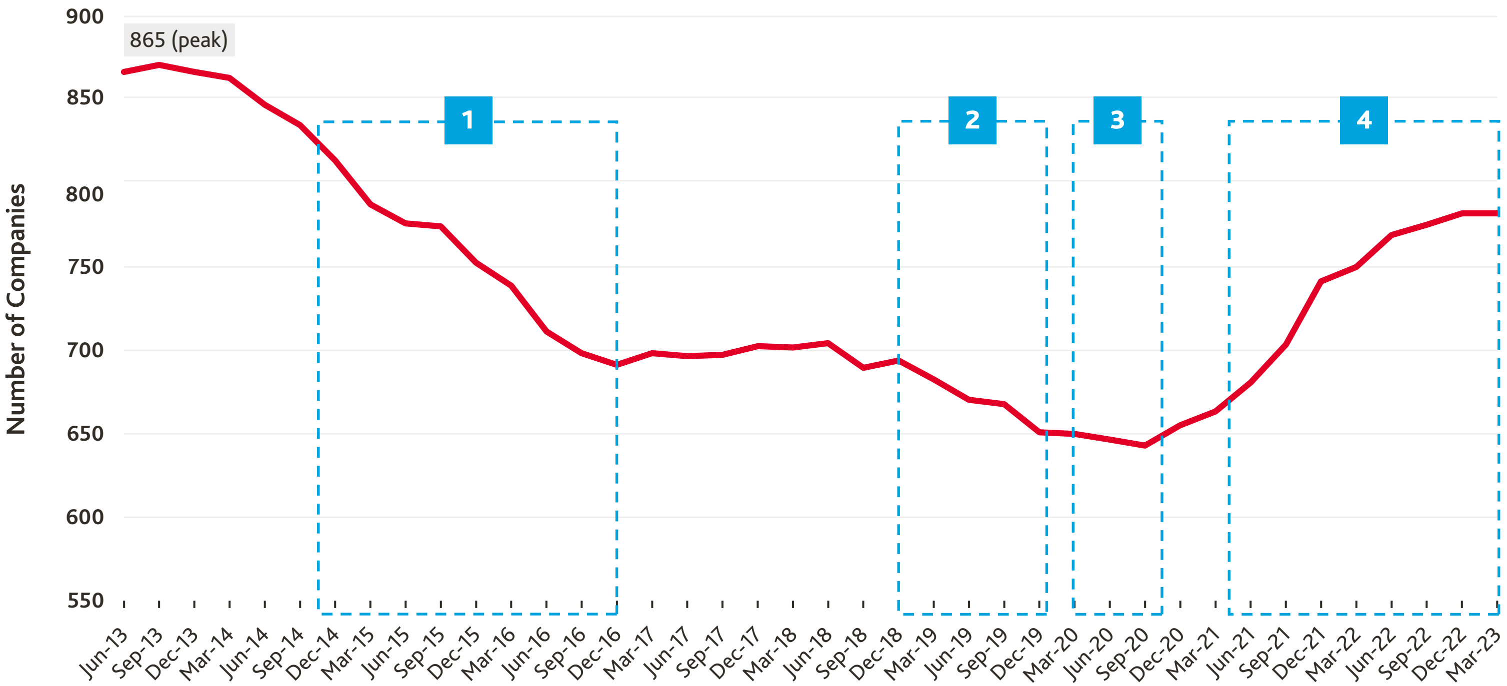
Across 2015 and 2016, the number of companies continued to drop, but at a more drastic rate. The number of explorers fell to 753 companies in December 2015 (2015 decline: 61 companies) and declined to 690 companies by December 2016 (2016 decline: 63 companies). The shrinking size of the sector during this period was primarily driven by a large amount of backdoor listings, particularly by technology and biotechnology firms using exploration companies as a means to list on the ASX via a reverse takeover route. Also contributing to the decline, were companies being either delisted or suspended from the ASX due to lack of operating activities and a diminished level of funding to pursue new opportunities.

The first reversal of this trend came in March 2017, albeit only by an increase of eight companies. This increase was driven by a slight resurgence in the number of IPOs within the sector and the introduction of new ASX listing rules, which reduced the amount of backdoor listings. The size of the sector then remained consistently around the 700 company mark with this overall plateau attributed to an increased level of IPOs offsetting the number of delisting's and suspensions.

The next wave of declines occurred in September 2018 through to the end of 2019, but notably at a lesser extent compared to the 2015/16 years. This trend was mainly the result of consolidation activity within the sector, particularly for gold companies, where producers were actively pursuing late stage exploration companies to shore up their resource base amidst favourable prices.

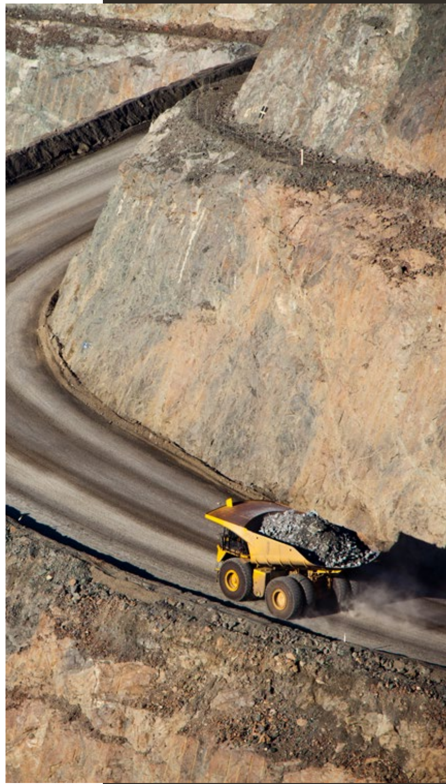
Then, to exacerbate the declining number of companies due to consolidations, COVID-19 hit, with the impacts witnessed in March 2020 when financing activity ceased, heavily impacting IPOs in the June and September 2020 quarters. However, the effects of the pandemic quickly changed its tune, when cash injections into the economy caused capital markets to thrive and investor appetite for gold and battery metal stocks increased. BDO witnessed an unprecedented number of IPOs entering the market, which is clearly observable from the data below with 153 new companies joining from September 2020 to March 2023.

NUMBER OF COMPANIES TO LODGE 5B REPORTS FROM JUNE 2013 – MARCH 2023



1. Tech and Biotech companies undertaking backdoor listings on exploration companies.
2. Consolidation activity within the sector, particularly from gold companies.
3. Further decline in number of companies due to COVID-19.
4. Post COVID-19 IPO surge due to favourable capital markets.

CASH BALANCES



Cash is the lifeblood of exploration companies. The long-term graph below outlines the proportion of exploration companies with cash balances of more (or less) than $1 million, as well as the average cash balance per company. The broad trend shows just how unprecedented the cash position of the exploration sector has been in recent quarters, following the surge of funds into the sector post June 2020, resulting in explorers truly being 'cashed-up'.

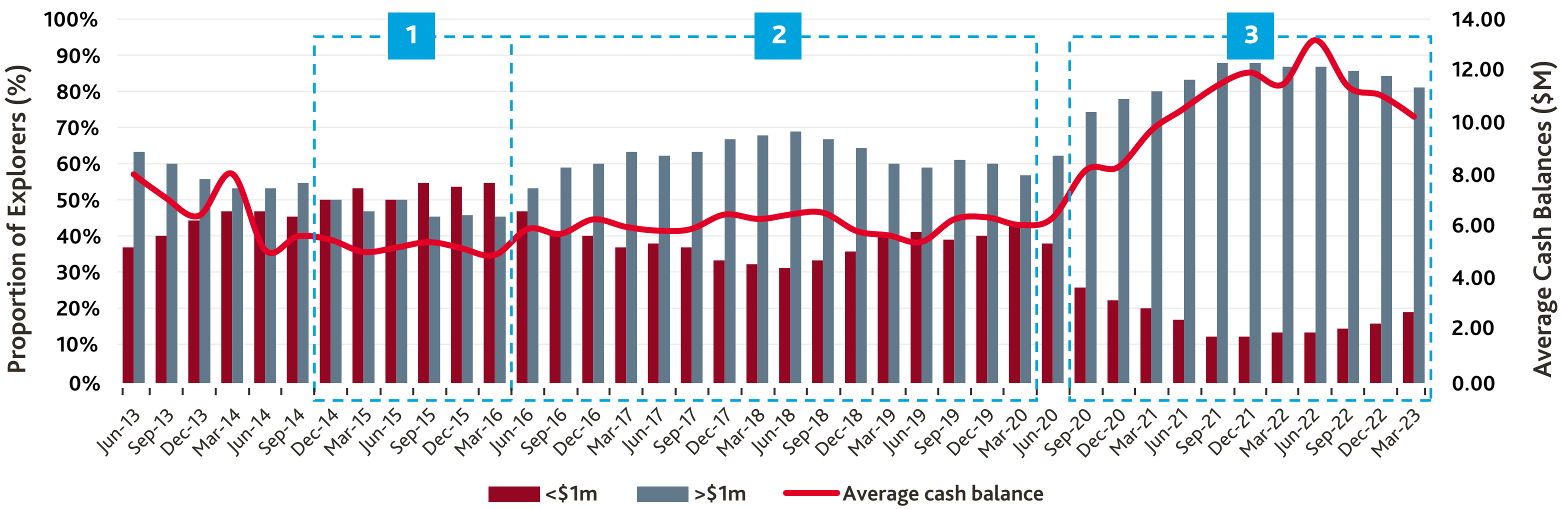
Back in June 2013, 63% of exploration companies reported a cash balance of more than $1 million, which represented a decent majority. However, in light of challenging market conditions for ASX listed exploration companies, funds seemed to flow towards other sectors, which resulted in a cash burn that left more explorers with less than $1 million in the bank by March 2015. During this period, average cash balances also reduced and averaged $5.21 million from June 2014 to March 2016.

June 2016 reflected an increase in financing with the majority of companies having more than $1 million in the bank again. However, growth in average cash balances remained subdued, largely due to stronger exploration activity having an offset effect on newly raised funds.

Then, in September 2020, post-COVID 19 financing spiked and so did cash balances. Both average cash balances and the proportion of companies with $1 million and above continued to increase as companies took advantage of the favourable capital markets to raise funds, whilst withholding from undertaking large spends due to residual economic uncertainty. However, this trend has started to taper off in the last three quarters to March 2023 as capital markets have since cooled whilst strong levels of exploration spending persist.

Although some explorers have started to enter into cash preservation mode amidst current economic uncertainty and high interest rates, a look back on the last ten years of data shows explorers are still cashed-up like never before.

ASX EXPLORERS' CASH POSITIONS



1 Cash flow into exploration sector tightens and more companies had less than $1 million.

2 Proportion of cash balances over $1 million grows but average cash balances remain subdued due to higher level of exploration expenditure.

3 Capital markets boom after initial COVID-19 dip and explorers raise large amounts of cash.

FINANCING CASH FLOWS

Although our analysis commenced in June 2013, specific financing inflow and outflow data was only tracked starting from March 2015 quarter. At the time, the sector comprised 793 companies that raised a total of $847 million. Financing inflows then averaged $1.0 billion over the four quarters to December 2015 before contracting by 48% in March 2016 driven by low commodity prices and low demand for commodities.

Inflows then bounced back and exhibited an increasing trend across mid-2016 to 2017, primarily driven by funding into gold, oil and gas and lithium companies. In particular, a growth in investment into gold as a safe-haven asset followed the announcement of Britain's proposed exit from the European Union (Brexit) as well as the US Presidential election of 2016, which contributed to significant uncertainty in global markets.

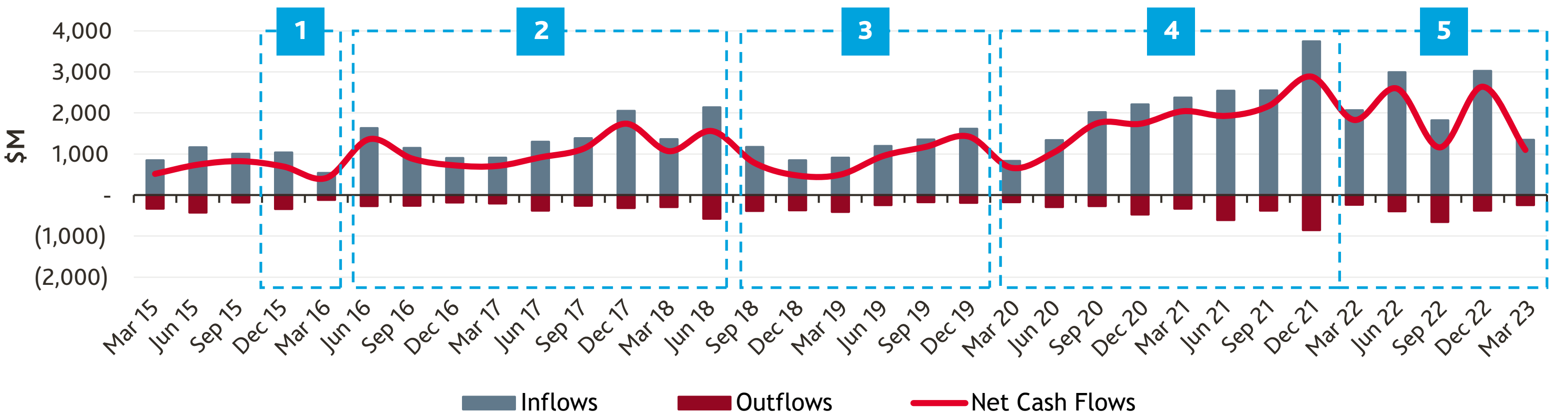
Financing remained strong to mid-2018, before decreasing by 45% in September 2018. This was caused by volatile capital markets underpinned by concerns surrounding global trade tensions and rising interest rates. These conditions continued to weigh on the sector, albeit at a diminishing rate as financing inflows gradually climbed each quarter to December 2019.

Then, financing inflows plummeted 48% to a four-year low of $834 million in the March 2020 quarter. This was of course driven by the plunge in global financial markets due to the emergence of the COVID-19 pandemic. At the time, the outlook for the sector was extremely uncertain and we saw a temporary pause in all financing, investing and operational activities.

However, low interest rates coupled with government stimulus into the Australian economy saw investors turn their attention to equities, and we started to see both retail and institutional investors pouring funds into the exploration sector (especially for IPOs) in pursuit of better returns. Markets bounced back and financing inflows reached historical levels as the world recovered from the effects of the pandemic. In the December 2021 quarter, financing inflows peaked to $3.75 billion, which is the highest we have seen since.

Financing cash flows were more volatile over 2022 and now to March 2023. Rising interest rates, inflation and geopolitical events like Russia's invasion of Ukraine led to much more turbulent market conditions, and although funds are still flowing into the sector in waves, we observe that this is primarily for more advanced development projects, particularly for battery metals and energy transition commodities.

FINANCING CASH FLOWS ($M)



1 Contraction due to low prices and low demand for commodities.

2 Brexit and the US presidential election promote gold financing.

3 Global trade tensions and rising interest rates weigh on sector but financing gradually improves.

4 COVID-19 pandemic crash and rapid recovery. Low interest rate environment and high demand for commodities.

5 Slowing of previous trends, increased demand for certain minerals, interest rate rises, geopolitical uncertainty and high inflation.

EXPLORATION EXPENDITURE

After peaking at $920 million in March 2014, total exploration expenditure declined quarter-on-quarter until reaching $267 million in March 2016, representing a 71% decline in two years. The fall in exploration expenditure can largely be attributed to the overall decrease in the number of companies in the sector, as well as the gradual decline in average exploration spends with capital markets and cash balances being relatively subdued.

Exploration spending then recovered from June 2016, albeit at a slow pace, and the total exploration spend per quarter averaged $349 million from June 2016 to March 2018. Average exploration spending also grew, driven by an uptick in exploration activity for gold and oil and gas companies, following on from the announcement of Brexit and the US presidential election.

A significant event for the sector, and hence exploration activity, was the introduction of the Junior Minerals Exploration Incentive (JMEI) scheme after the legislation was passed by Federal Parliament in March 2018. The JMEI allows mineral exploration companies with no mining income to pass their tax losses through to eligible investors who take up shares that are issued through a capital raise. Many ASX-listed exploration companies applied and qualified for the JMEI, which led to a steady increase in exploration activity in late 2018. Exploration expenditure strengthened and averaged $450 million in the two years to March 2020.

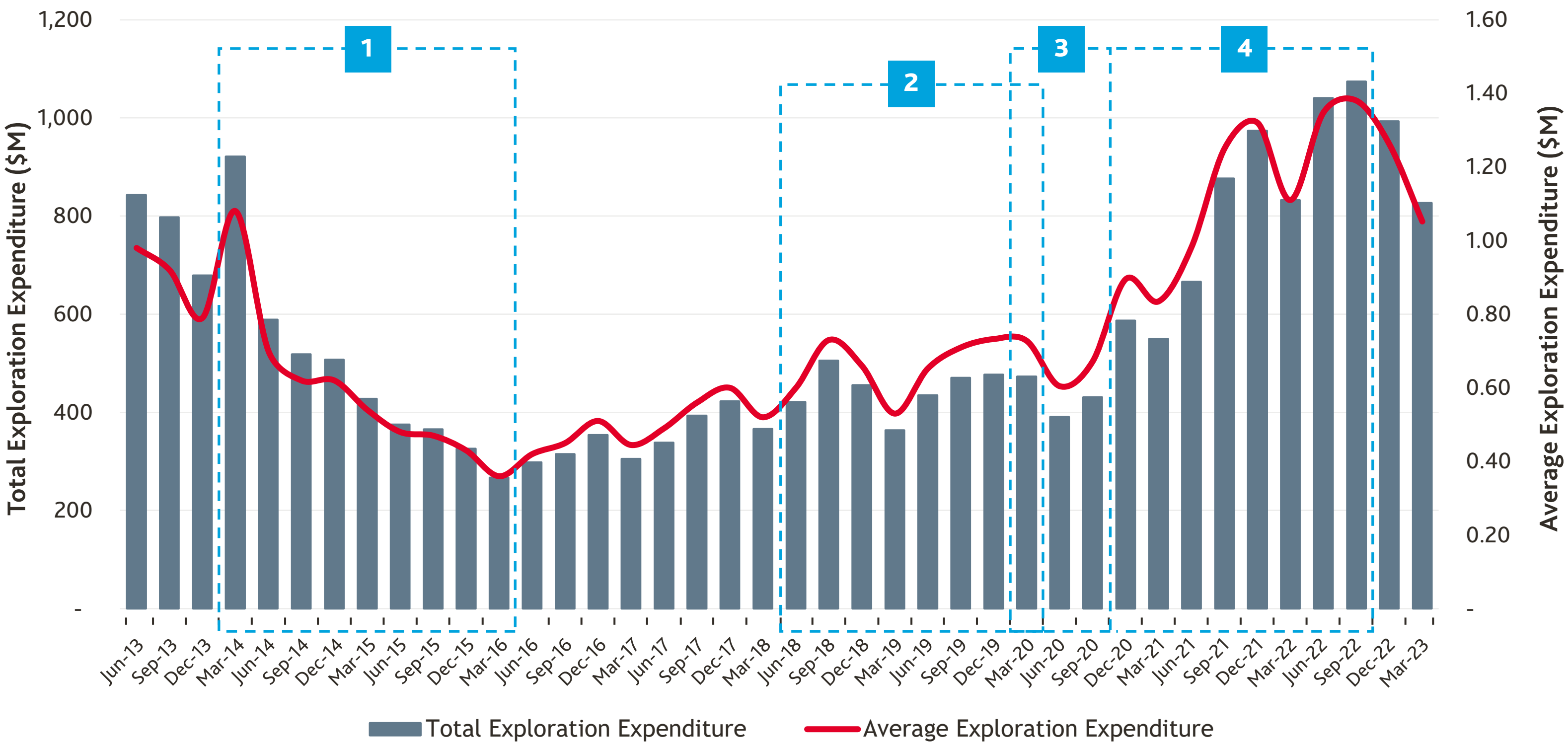
At the onset of the COVID-19 pandemic in the March 2020 quarter, exploration spending first appeared seemingly unaffected, only decreasing by 1% from the prior quarter. However, this turned out to be a time lag factor with the 'hit' to capital markets in March only translating to reduced exploration spending in the June 2020 quarter.

As seen from previous graphs, capital markets quickly bounced back in mid-2020 with funds entering the sector at unprecedented levels, but the persistent economic uncertainty, restricted access to sites as well as a limited supply of equipment caused by pandemic restrictions, continued to hinder exploration spending in the June and September quarters of 2020.

However, it was only a matter of time before money raised became money spent, and exploration spending skyrocketed 125% from September 2020 to December 2021 to $973 million, and subsequently exceeding $1 billion in the June and September quarters of 2022. This was particularly noteworthy as the sector only comprised approximately 750 companies during this period, whilst the earlier periods of 2013 and 2014 recorded over 850 companies. This was reflected in the average exploration spends per company, which can be seen to have reached historical levels.

Exploration spending has since tapered off slightly as capital markets have tightened and cash reserves have slowly dried up. However, the graph below shows that exploration spending still remains strong, with $827 million spent in the March 2023 quarter.

TOTAL EXPLORATION EXPENDITURE ($M)



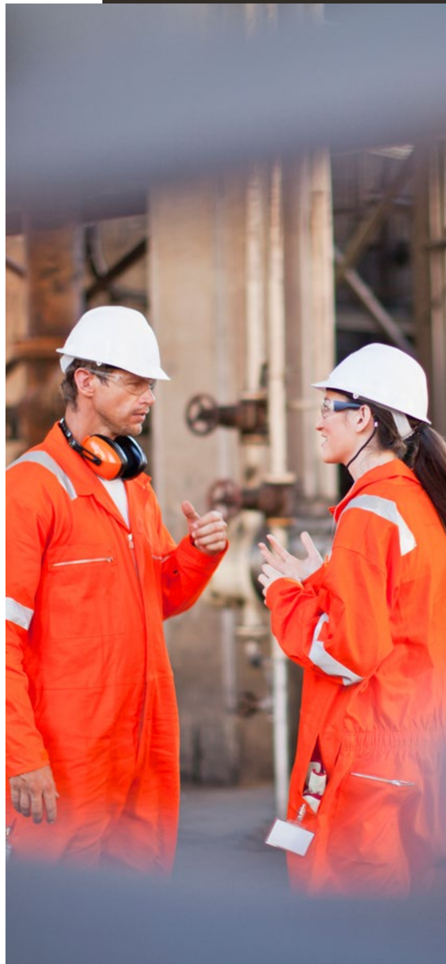
1 Decrease in exploration activity due to reduced number of companies and average exploration spends due to lower cash balances and capital raisings.

2 JMEI is introduced and helps strengthen exploration activity.

3 Economic uncertainty, restricted site access and equipment shortages kept exploration spending subdued despite the uptick in sector funding.

4 Exploration sky rockets as funds raised post COVID-19 start translating to investment into the ground.

ADMINISTRATION EXPENDITURE



Administration expenditure primarily relates to listing fees, professional fees, director fees and other corporate costs, which have been analysed within our dataset since the March quarter of 2015.

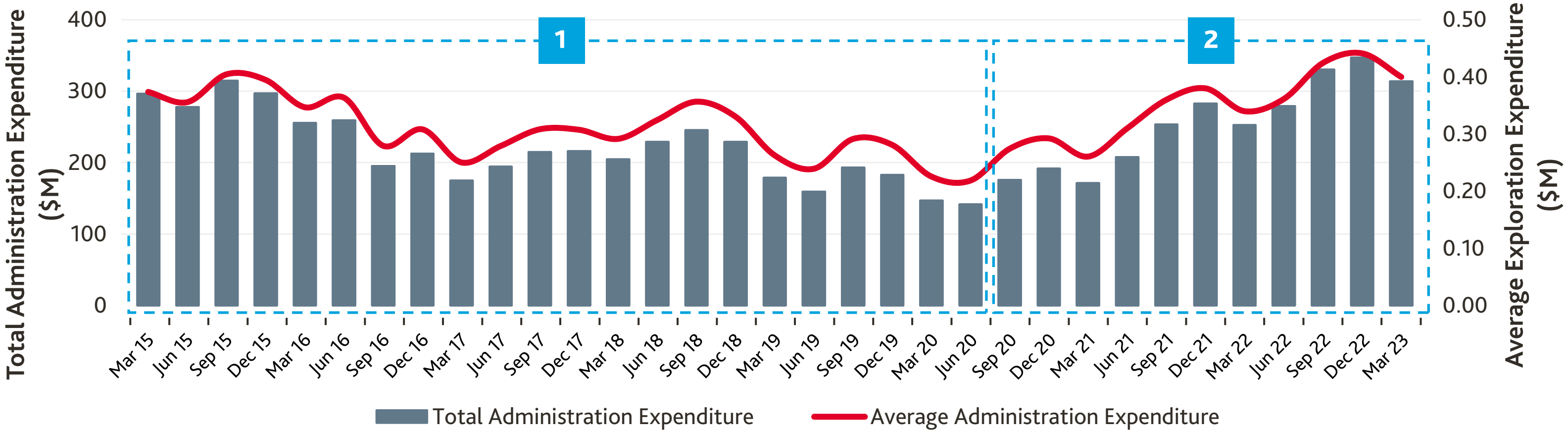
Total administration expenditure across the eight-year period averaged $231 million per quarter, with the bar graph broadly reflecting a U-shaped trend over the period. This is understandable when considering how total administration spending has mirrored the number of companies within the sector from 2015 to 2023.

In terms of average administration expenditure per company, we observed that this has exhibited a broad downwards trend from March 2015 to June 2020. This was due to companies facing greater pressures amidst relatively subdued market conditions at the time, to preserve their overheads in order to funnel more funds raised towards progressing the exploration and development of their projects.

However, this trend has reversed since June 2020, with average administration spending increasing back to historical levels. This is linked to the increased level of exploration activity, capital raises, and merger and acquisition activity, which has resulted in higher corporate expenses per company. In addition, the prevalence of corporate skilled labour shortages since COVID-19 has placed upward pressure on the remuneration of corporate staff and the quantum of fees paid to external advisers. Administration costs of late have also suffered the impact of the recent inflationary environment, where Australia's inflation rate, which hit 7.8% over the 2022 calendar year, represented the highest year-end inflation figure since 1990.

Another interesting trend that we observed over the years, is the cyclical nature of administration expenditure, for which spending appears to be lower in the March and June quarters of the year and higher in the September and December quarters. This is possibly due to transaction and adviser fees being incurred in the second half of the year, in line with the uptick in transaction activity typically seen prior to companies holding their annual general meetings.

ADMINISTRATION EXPENDITURE ($M)



1 Broad downward trend in average administration expenditure as companies face pressures to cut overheads.

2 Average administration spends grow due to increased corporate activities, labour shortages and inflation.

CONTACT US

SHERIF ANDRAWES
Head of Global Natural Resources
+61 8 6382 4763
sherif.andrawes@bdo.com.au

ASHTON LOMBARDO
Director, Corporate Finance
+61 8 6382 4917
ashton.lombardo@bdo.com.au

DAVID FECHNER
Partner, Tax & Advisory
+61 8 7421 1413
david.fechner@bdo.com.au

GARETH FEW
Partner, Audit & Assurance
+61 2 9240 9744
gareth.few@bdo.com.au

RICHARD SWABY
Partner, Audit & Assurance
+61 7 3237 5806
richard.swaby@bdo.com.au

ADAM MYERS
Partner, Corporate Finance
+61 8 6382 4751
adam.myers@bdo.com.au

CATHERINE DEAN
Partner, Corporate & International Tax
+61 2 8221 2243
catherine.dean@bdo.com.au

DAVID OCELLO
Partner, Tax
+61 8 6382 4778
david.ocello@bdo.com.au

JAMES MOONEY
Partner, Audit & Assurance
+61 3 9603 1796
james.mooney@bdo.com.au

SCOTT BIRKETT
Partner, Corporate Finance
+61 7 3237 5837
scott.birkett@bdo.com.au

FOR MORE INFORMATION

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