Q3 – EXPLORER QUARTERLY CASH UPDATE

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RESEARCH INTO THE FINANCIAL HEALTH OF AUSTRALIAN LISTED EXPLORERS: Q3 (Quarter ended 31 March 2016)

THERE ARE OPPORTUNITIES IN THE INDUSTRY - YOU JUST NEED TO KNOW WHERE TO LOOK!

- LITHIUM AND GOLD CONTINUE TO OUTPERFORM OTHER COMMODITIES
- CASH PRESERVATION CONTINUES TO BE THE THEME
- IS THE MARKET SHIFTING AWAY FROM THE BACK-DOOR LISTING ROUTE?
- WILL WE SEE MORE IPO'S IN THE COMING QUARTERS?

BDO's report on the cash position of Australian-listed explorers for the March 2016 quarter (based on quarterly Appendix 5B reports lodged with the ASX), again shows a decrease in the number of companies reporting and a decrease in the average of exploration expenditure.

There is a declining trend in the number of companies lodging their Appendix 5B reports from 778 for the September 2015 quarter to 753 in the December 2015 quarter and further to 737 in March 2016.

We continue to see technology companies back-dooring into exploration companies, which explains a majority of the decline in the number of reporting companies. Partially offsetting this trend during the quarter has been five companies being reinstated from suspension following capital raisings.

In summary, the key findings of the quarterly update reveal the following:

- The average exploration expenditure has continued to fall for the eighth straight quarter to $362,000, a significant decrease from $432,000 in the December 2015 quarter.
- There has been an increase in the percentage of companies that have not undertaken exploration activities, highlighting that companies are in cash preservation mode.
- Those companies with cash are looking to hold onto it, whilst across the board exploration companies are cutting back on expenditure.
- The current economic climate may be causing those companies with significant cash reserves to cut administration expenditure.
- There are companies generating value through developing existing assets through to production. One of these success stories being Blackham Resources.
- Exploration companies are slowly running down their cash balances, with the average cash balance decreasing from $5.15 million at 31 December 2015 to $4.82 million at 31 March 2016.
- 14 companies were used as listing vehicles for backdoor listings, 13 of which were technology or biotechnology assets.
- Two companies were delisted during the period, two exploration companies conducted an IPO and five were readmitted (from suspension) following a capital raising.
- The number of companies that raised cash flows in excess of $10 million in the March 2016 quarter was seven, down from 17 in both the September 2015 and December 2015 quarters.

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"This quarter is showing a significant decrease in the number of companies reporting a stable level of exploration expenditure"

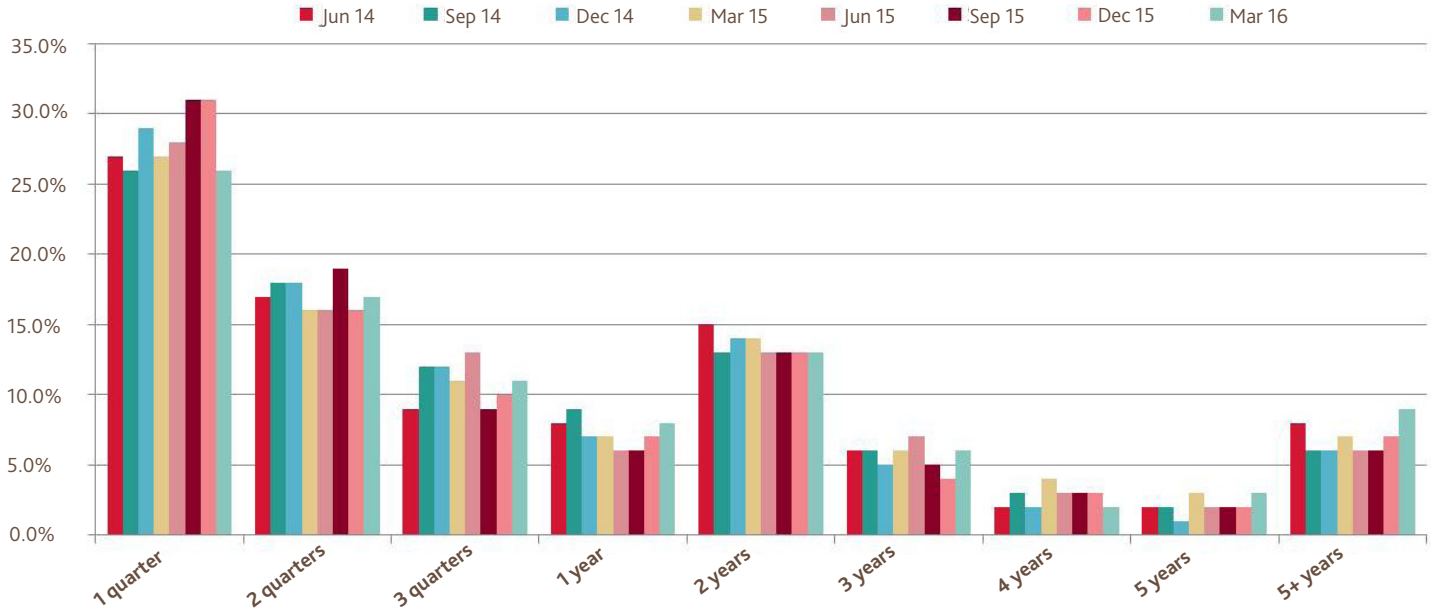
Adam Myers
Partner, Corporate Finance

MARCH 16 QUARTER CASH POSITION

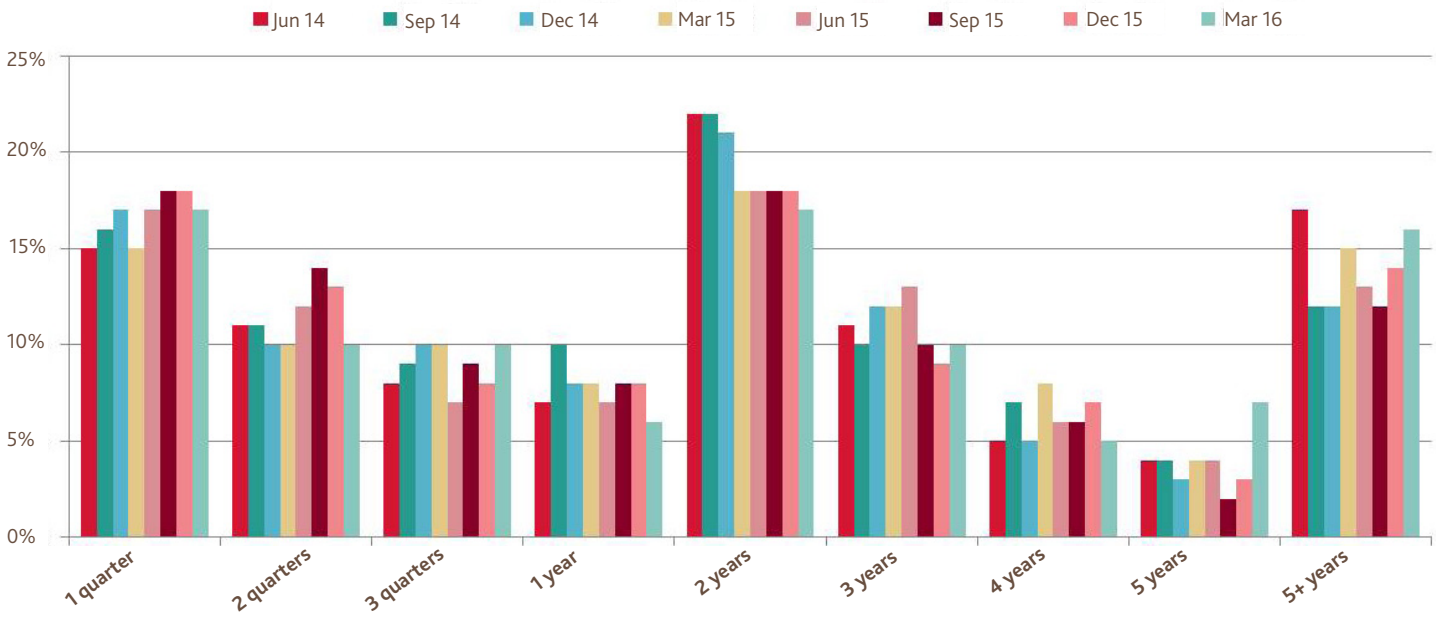
	DECEMBER 15 QUARTER		MARCH 16 QUARTER	
	No.	%	No.	%
Total number of companies lodging Appendix 5B's	753	100%	737	100%
Net Operating Expenditure				
- Companies with one quarter cash reserves	226	30%	183	25%
- Companies with two quarters' cash reserves	357	47%	315	43%
Administrative Expenditure				
- Companies with one quarter cash reserves	130	17%	121	16%
- Companies with two quarters' cash reserves	228	30%	119	27%

OPERATING EXPENSES - CASH BURN RATE

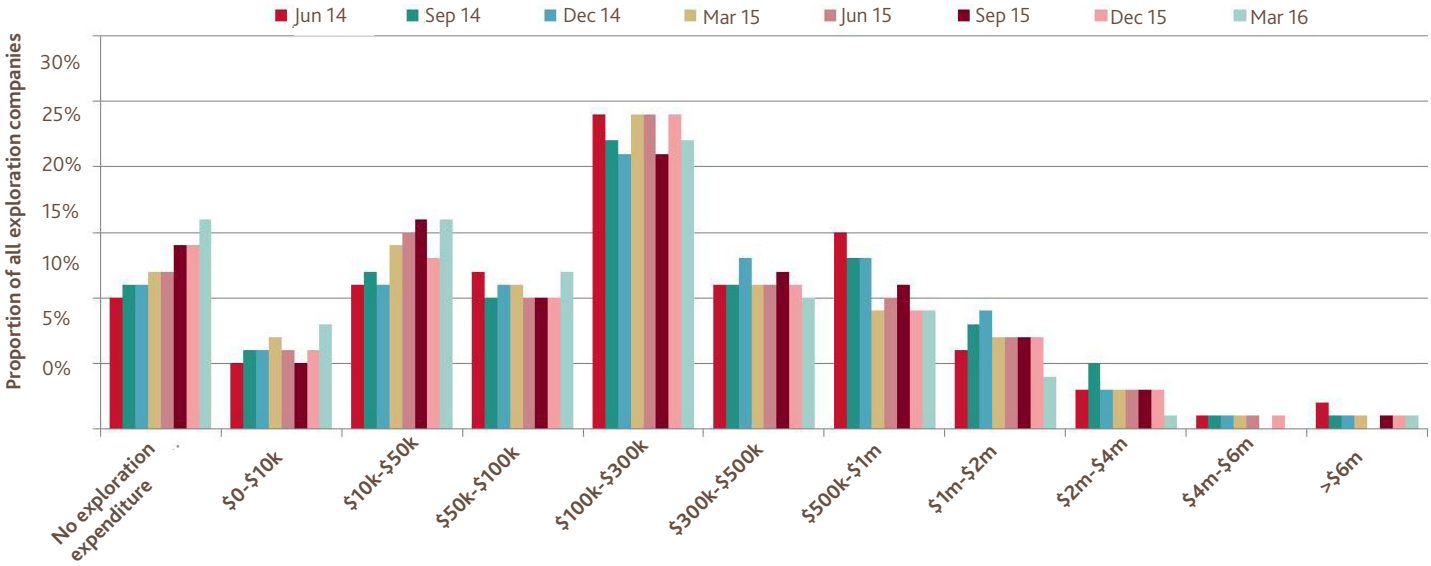
The following graphs provide a snapshot of the operating, administration and exploration expenditure across the sector:



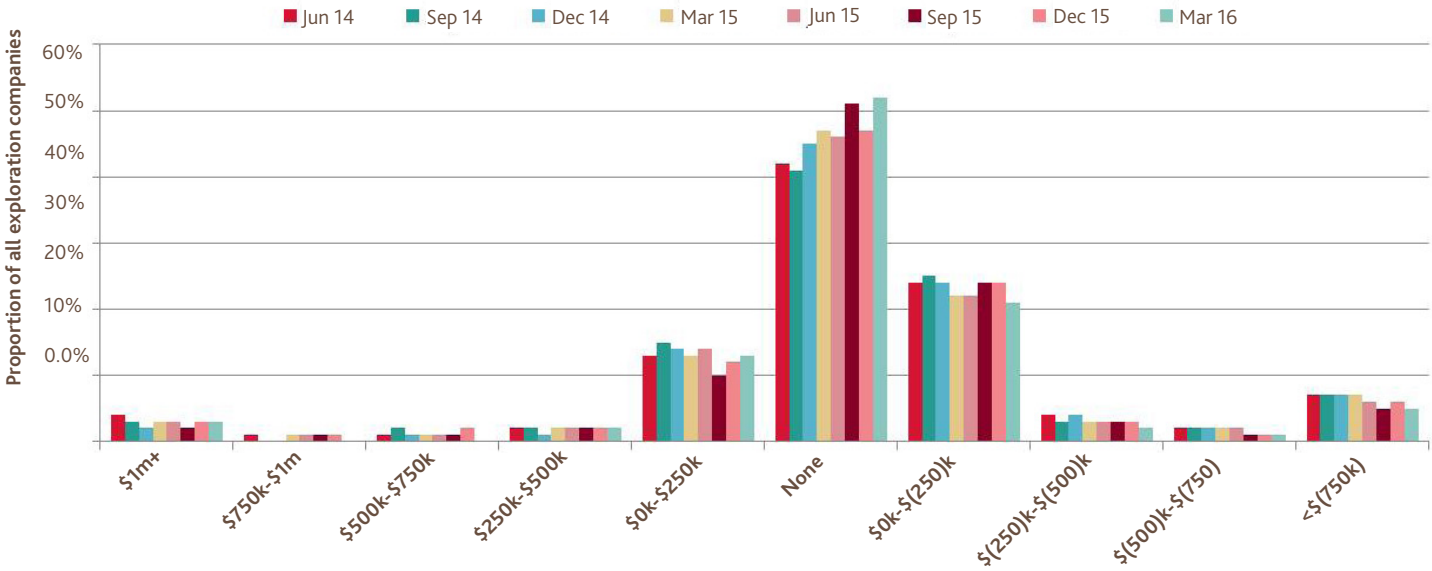
ADMINISTRATION EXPENSES - CASH BURN RATE



TOTAL EXPLORATION EXPENDITURE



NET INVESTING CASH FLOWS



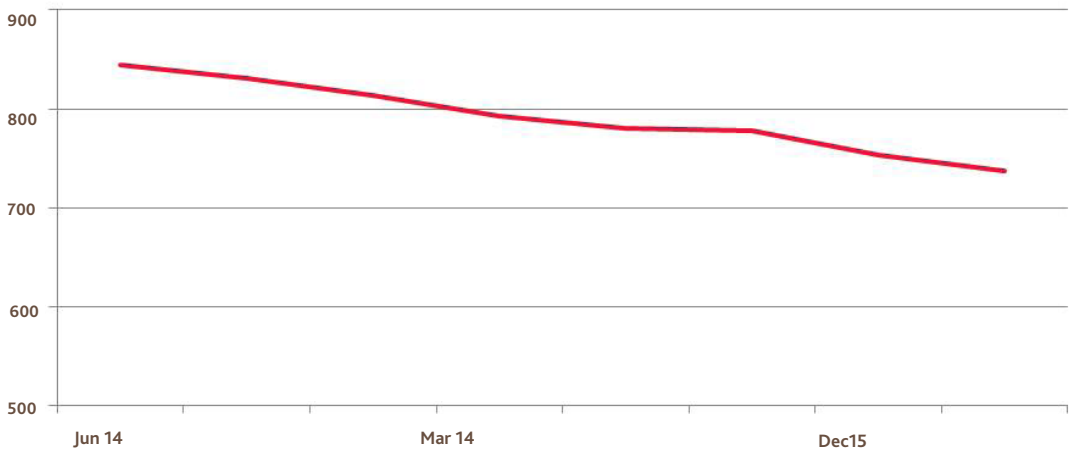
Points to note in relation to the above graphs are:

- In line with previous quarters, a majority of companies sit in the bracket of having exploration expenditure in the quarter of between $100,000 and $300,000. However, there has been an increase in the percentage of companies that have not undertaken exploration activities over the review period, with an increase to approximately 16%, up from 14% in December 2015. This highlights that an increasing number of exploration companies are going into cash preservation mode, which is supported by the increase in the percentage of companies with expenditure less than $100,000 from approximately 35% in December 2015 to approximately 40% in March 2016.
- Despite there being a decline in the total level of exploration expenditure, we consider there to be pockets of activity on a commodity specific basis. Exploration for commodities such as iron ore and copper has reduced, however there continues to be exploration for gold and lithium.
- Based on the March 2016 quarter's operating cash flows, there has been a decrease in the percentage of companies that will burn through their cash reserves in the next quarter, with the percentage for March being the lowest over the review period. This indicates that exploration companies continue to cut back on expenditure whilst those companies with cash are looking to retain it.
- In relation to administration expenditure, 37% of companies have only one or two quarters' of cash remaining (including companies with a negative cash balance) on current administration spend, which is above the average of 27% over the period from the March 2014 quarter to the September 2015 quarter. This result most likely reflects the number of companies which are no longer exploring and simply preserving their cash reserves to meet administrative costs whilst some are exploring alternative business options.
- Conversely, based on current administration spend, we have noticed an increase in the percentage of companies that have

three or more years of administration expenditure remaining, from approximately 35% in December 2015, to approximately 40% in March 2016. A possible reason for this is that in the current economic climate, even companies with significant cash reserves are looking to cut administrative expenditure in order to retain as much cash as possible. These administrative efficiency improvements bode well for future exploration and investment activity when these companies elect to increase exploration or transact.

- There has been an increasing trend in the percentage of exploration companies with nil investment expenditure, in particular there was an increase from 47% of all companies for the December 2015 quarter to more than 52% in the March 2016 quarter. This percentage was as low as 41% in the September 2014 quarter. This indicates a reluctance by explorers to invest and supports our theory of exploration companies being in cash preservation mode whilst some are considering alternative options. We note that those companies which are seeking a change of operations and successfully acquire a business or assets outside of exploration, are unlikely to have lodged an Appendix 5B and therefore will not be included in our dataset. These companies which are the subject of a backdoor listing are discussed further below.
- The average exploration expenditure has continued to fall for the eighth straight quarter to $362,000, a significant decrease from $432,000 in the December 2015 quarter. In previous quarters we have observed that the median exploration expenditure has remained relatively stable over the review period, however for the March 2016 quarter the median expenditure has also decreased from $130,000 to $91,000. This indicates that there has been a widespread reduction in exploration expenditure, rather than just at the smaller end of the market. We partly attribute this to a move by explorers to further develop their existing exploration assets (rather than explore), as well as companies' tendency to preserve cash.
- Whilst there has been a widespread decline in the level of exploration expenditure, this does not mean that there is a lack of opportunity for value accretion. There are companies generating value through developing existing assets through to production. One of these success stories is Blackham Resources and the progression of its Matilda Bay Gold project.
- The percentage of companies with the cash required to fund only one or two quarters of operating expenditure (including companies with a negative cash balance) has decreased from 47% in December 2015 to 41% for March 2016. This is a significant decrease from the 51% in September 2015 however the current level remains in line with the average between 30 June 2014 and 30 June 2015. We attribute this decrease to the fact that exploration companies are slowly running down their cash balances. This is evidenced by the average cash balance of exploration companies decreasing from $5.15 million at 31 December 2015 to $4.82 million at 31 March 2016.

NUMBER OF COMPANIES LODGING APPENDIX 5B REPORTS: JUNE 2014 – MARCH 2016

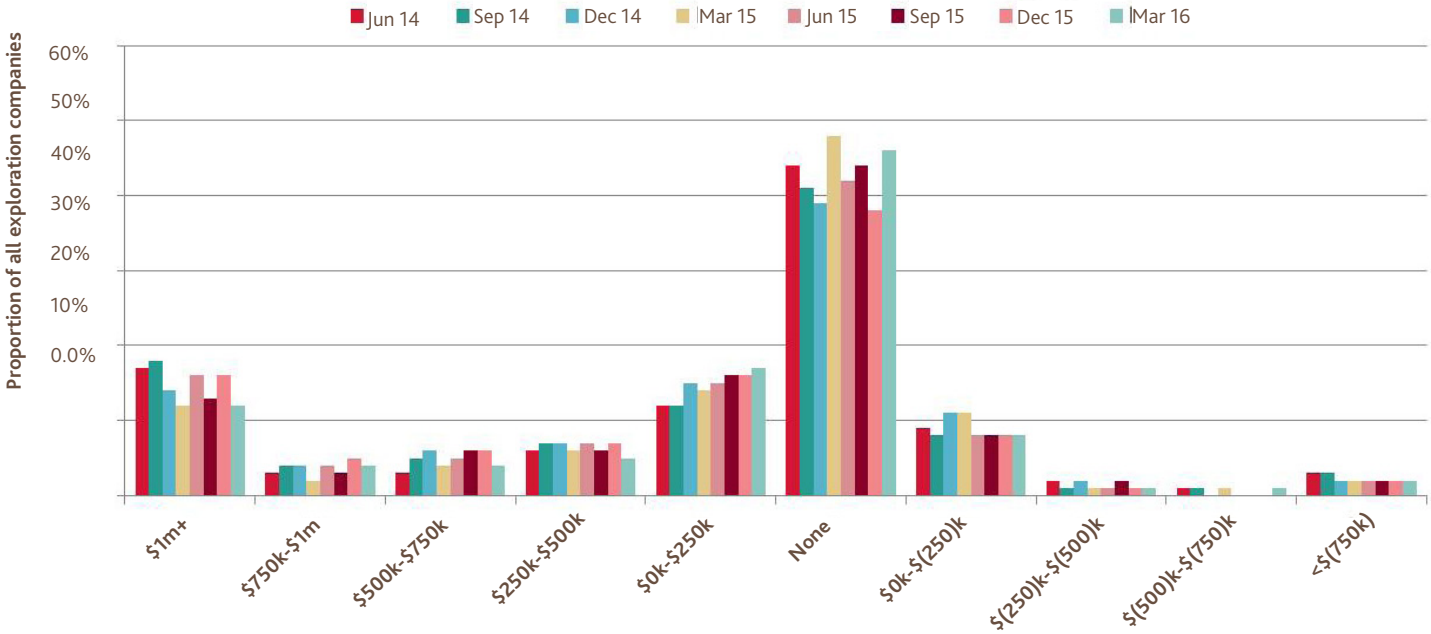


- There has been a declining trend in the number of Appendix 5B lodgements over the review period, with the number of companies lodging Appendix 5B's decreasing to 737 in March 2016 from 753 in December 2015. Despite the number of exploration companies decreasing, the rate of the decrease between periods is diminishing, with the reduction in the number of reporting companies comprising approximately 2.2% of exploration companies at 31 March 2016, compared to 3.3% at 31 December 2015.
- The net decrease from the December 2015 quarter to the March 2016 quarter of 16 companies was a result of the following:
  - 14 companies were used as listing vehicles for backdoor listings, 13 of which were technology or biotechnology assets. Of the 14, one (Aleator Energy's proposed acquisition of Vonex) fell over and was subsequently delisted by ASX.
  - Two other companies were delisted during the quarter.
  - One company (Neon Energy) changed operations and is now classed as an investment company.
  - One company (Eden Energy) sold its gas assets and is therefore no longer required to lodge an Appendix 5B.
  - Two companies entered into voluntary administration.

  - One company was liquidated.
  - Four companies did not lodge an Appendix 5B, for no identifiable reason.
- These reductions in the number of companies lodging Appendix 5B's were partially offset by two new listings of exploration companies and two companies that had a late lodgement for the December quarter and therefore were not included in our December 2015 quarter dataset.

There were also 5 companies which were suspended during the December quarter but were reinstated following capital raisings and therefore lodged in the March quarter. This shows that there is still an appetite in equity capital markets for exploration companies.

NET FINANCING CASH FLOWS



The proportion of exploration companies with positive financing cash flows has decreased in the March 2016 quarter to 42%, from 51% in the December 2015. This however still remains in line with the historical average of 43% between June 2014 and September 2015.

FUND FINDERS

The number of companies with nil financing cash flows for the quarter has increased to approximately 46% in March 2016, up from 38% in December 2015. The average net cash inflows for the period has also decreased from approximately $926,000 in December 2015 to $563,000 in March 2016. The number of companies that raised cash flows in excess of $10 million in the March 2016 quarter was seven, down from 17 in both the September 2015 and December 2015 quarters. Despite this, we still see considerable shareholder interest in particular segments of the market. Lithium and gold stocks again appear to be favoured by investors. The companies that raised funds through either debt or equity are set out below:

- **Australian Pacific Coal Limited** (coal) - $20m convertible loan debt.
- **Avenira Limited (**phosphate) - $12.277m from proceeds from issues of shares, options etc and $15.415m gross proceeds from the sale of a subsidiary.
- **Blackham Resources Limited** (gold) – $21.625m from proceeds from issues of shares, options, etc.
- **Doray Minerals Limited** (gold) - $15m borrowings and $426,000 from issues of shares, options etc.
- **Eastern Goldfields Limited** (gold) – $24.433m proceeds from issues of shares, option etc.
- **Finders Resources Limited** (copper, gold-silver) - $45.596m proceeds from borrowings.
- **Orocobre Limited** (lithium) - $83.375 proceeds from issues of shares, options, etc.

As noted in previous editions, the market continues to favour gold in times of economic uncertainty, market volatility and falling commodity prices, with three of the above seven major fund raisings coming from gold exploration companies. Those companies with successful projects are finding it easier to attract capital, as there are less economically viable projects competing for funds. The uncertainty and degree of negative sentiment surrounding the mining and exploration industry presents opportunity for investors as industry risk is considered when setting capital raising prices. We certainly consider there to be pockets of value throughout the industry, which the market seems to be identifying. One of the success stories of the quarter, Blackham Resources, raised over $21 million, with their placement being oversubscribed and receiving solid institutional support. The funds raised are being used on the Matilda gold project, specifically on the refurbishment of the Wiluna Gold Plant to enable a transition through to production.

It is also interesting to note a significant capital raising by Orocobre Limited an Argentinian lithium producer. We also observed a number of other smaller scale capital raisings by lithium explorers such as Pilbara Minerals and Lithex Resources. Interestingly, on 13 May 2016, Lithex Resources announced a vertical integration strategy whereby it plans to acquire Voltape Ltd, which specialises in the development of faster and more sustainable lithium-ion battery technology. This highlights that there still remains significant interest in the lithium space. Post the 31 March 2016 period end we also note that Pilbara Minerals raised $100 million, highlighting that capital is available to specific sectors.

BDO INSIGHT

The environment continues to be a challenging one for the exploration sector, despite notable exceptions for lithium and gold which continue to attract attention and perform strongly, it will be interesting to see what happens in the sector.

In respect of our hypothesis that the market may be drifting away from the backdoor listing route we note the release on 12 May 2016 of proposed changes to the ASX listing rules. The key changes to these rules that will impact on backdoor listings are

- An increase of the minimum investment amount from $2,000 to $5,000.
- A requirement for a minimum free float of 20%.
- An increase of the net tangible assets required for listing from $3m to $5m or a market. capitalisation of $20 million vs. the previous threshold of $10m.

Our view is that these requirements will make it difficult for Backdoor listings to proceed other than in limited circumstances, this may certainly lead to issues for a number of listed company shells who have exhausted much of their cash reserves and without the ability to undertake a transaction may face no alternative other than entering into administration. We are aware that consideration may be given to a proposal to carve out exploration companies from some of the proposed rules which we would certainly support. This would provide the opportunity for assets to be redistributed through the industry and provide an opportunity for shareholders stranded in a shell to have a potential opportunity to realise an enhanced value in the future.

We maintain the view that in difficult times there may be quality assets stranded by virtue of funding having to be allocated among a portfolio of assets and by moving the asset to a vehicle and providing the opportunity to fund that asset can be a source of wealth creation. This is no better illustrated than the acquisition of the Victor Long operation by Independence Group who recommissioned the mine in 2002 for it to become a cornerstone project of what would become a highly successful group. Whilst this strategy is not always successful it would be a missed opportunity if the listing rules prevent this type of transaction.

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