Q1 – EXPLORER QUARTERLY CASH UPDATE

BDO

RESEARCH INTO THE FINANCIAL HEALTH OF AUSTRALIAN-LISTED EXPLORERS: Q1 (QUARTER ENDED 30 SEPTEMBER 2016)

EXPLORATION EXPENDITURE INCREASES FOR SECOND SUCCESIVE QUARTER

- **GOLD CONTINUES TO OUTPERFORM OTHER COMMODITIES**
- **NUMBER OF BACKDOOR LISTINGS FALL**
- **NET OPERATING CASHFLOWS UP 34%**
- **WE EXPECT A DECLINE IN ACTIVITY IN DECEMBER, BUT IT IS NOT ALL DOOM AND GLOOM**

BDO's report on the cash position of Australian-listed explorers for the September 2016 quarter (based on quarterly Appendix 5B reports lodged with the ASX), shows that there has been an increase in both total exploration expenditure and operating expenditure, despite the decrease in number of companies reporting. Cash reserves, financing and investing cash flows have declined after significant growth last quarter, however still remain higher than averages exhibited in recent periods.

For the quarter ended 30 September 2016, 698 companies lodged an Appendix 5B report, which was 15 less than the 713 to lodge in the June 2016 quarter and 80 less than the 778 companies that lodged during the same period last year. The declining number of companies reporting exploration activity is primarily attributable to the previously observed trend of technology companies using exploration companies as a means to list on the ASX via reverse takeovers. This trend has been slowing in recent periods with ASX and ASIC making it more difficult for companies to list via a reverse takeover. From this we have seen an increase in the number of IPOs opposed to backdoor listings. The release of the updated Admission Requirements by the ASX in November 2016 which scaled back the more onerous rule changes that had initially been proposed may breathe some life back into the backdoor listing market, but it is unlikely. Further guidance from ASIC released in the update to RG228 on 3 November 2016 will likely exacerbate this trend over the coming periods. BDO's position on the new guidance is set out in the paper 'The Good and the Bad of ASIC's Revised RG 228'.

Despite a decline in the number of reporting companies, average exploration expenditure increased for the second successive quarter after nine quarters of sustained decreases. Furthermore, net operating cash flows increased during the September 2016 quarter from $527 million for the June 2016 quarter to $707 million, an increase of approximately 34%. The increase in funds committed to exploration and development reaffirms the improvement in industry sentiment, which was identified last quarter.

Total net financing cash flows decreased by almost a third for the September 2016 quarter, having increased by more than 300% during the previous quarter. However, the ability of explorers to secure debt and equity funding remains significantly higher than in periods prior to the June 2016 quarter, which indicates that there is still investor appetite for companies demonstrating strong fundamentals and reasonable valuation levels.

In particular, gold stocks and oil & gas stocks received significant financing cash flows, with 10 gold companies and four oil & gas companies raising in excess of $10 million during the September 2016 quarter. The interest in gold was reflective of heightened economic uncertainty that arose during the quarter due to the US Presidential Election. Uncertainty surrounding the election and its effect on the global economy will continue until the Trump Government is officially inaugurated and the details of its proposed policies are disclosed in the initial period of presidency.

Increased exploration and operating expenditure coupled with lower net financing cash flows has resulted in a decrease in the average cash balance from $5.85 million at 30 June 2016 to $5.68 million at 30 September 2016. The willingness for companies to use cash reserves for exploration and operating expenditure further illustrates the improvement in industry sentiment and suggests a positive outlook.

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

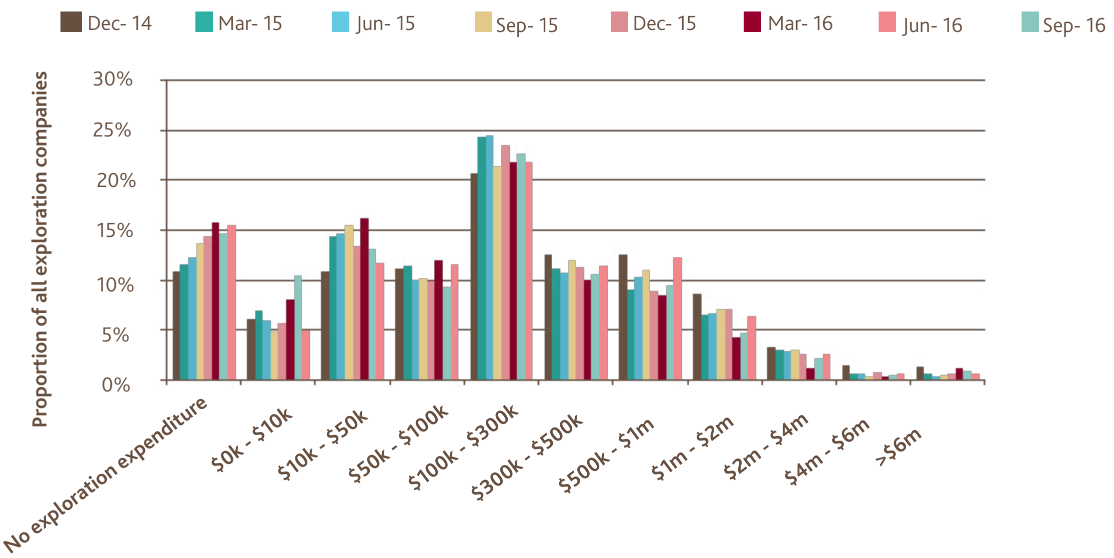
- The average exploration expenditure increased for the second successive quarter, from $418,000 in the June 2016 quarter to $451,000 in the September 2016 quarter. This comes after nine quarters of sustained reductions in total exploration expenditure.
- In the September 2016 quarter, 698 companies lodged Appendix 5B reports, a decline of 2.15% from the 713 companies that lodged reports in the June 2016 quarter.
- Reasons for the reduction included four companies being the subject of backdoor listings, all of which were technology related companies, and 12 companies being delisted or suspended.
- The number of companies with positive financing cash flows declined marginally (from 50.9%), with 50.1% of companies able to raise funds via either capital raisings or through borrowings during the September 2016 quarter.
- Total net financing cash flows decreased by $0.47 million, with the average per company decreasing from $1.91 million in the June 2016 quarter to $1.27 million in the September 2016 quarter. Despite the decrease, the ability for explorers to obtain debt and equity funding remains markedly higher than in quarters prior to June 2016.
- The number of companies that raised in excess of $10 million in the September 2016 quarter was 24, down nine from the 33 in the June 2016 quarter. Of the $1.15 billion in financing cash inflows for the September 2016 quarter, these 24 companies accounted for $0.58 billion, approximately 50%.
- Average cash reserves decreased marginally from $5.85 million for the June 2016 quarter to $5.68 million for the September 2016 quarter. This indicates that companies are transitioning away from a mindset of cash preservation and instead focusing on investing in exploration and the development of their projects.
- The amount of explorers with a net investment in capital expenditure has increased from 33.5% for the June 2016 quarter to 37.5% for the September 2016 quarter. However, net investment expenditure decreased by almost a third, from $149 million during the June 2016 quarter to $102 million in the September 2016 quarter.
- 9 companies were delisted and another three were suspended from the ASX during the quarter. These were partially offset by the addition of three exploration companies that conducted an IPO during the quarter.
- Shareholders showed keen interest in gold stocks in response to increased economic uncertainty resulting from the US Presidential Election.

SEPTEMBER 16 QUARTER CASH POSITION

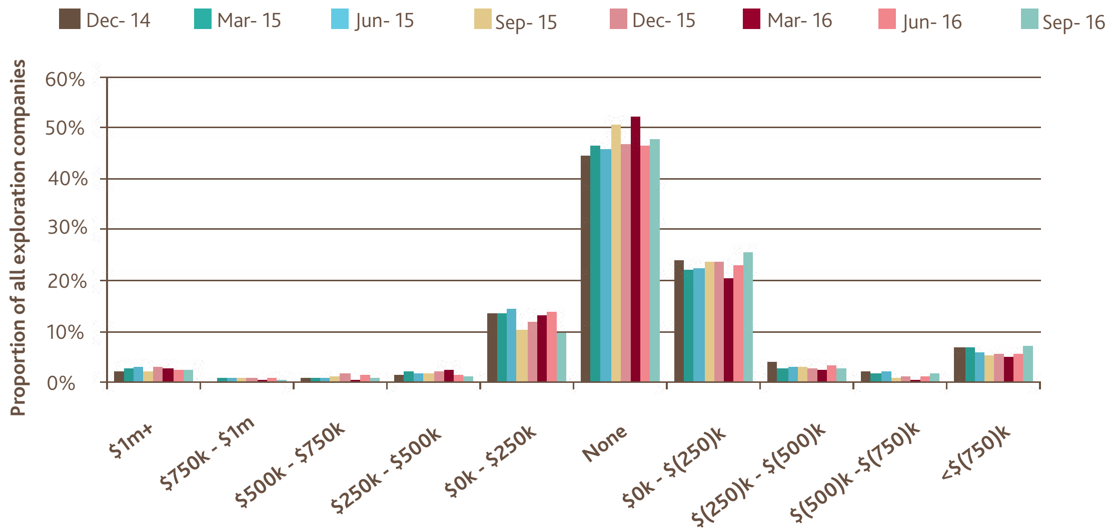
	SEPTEMBER 16 QUARTER		JUNE 16 QUARTER	
	No.	%	No.	%
Total number of companies lodging Appendix 5Bs	713	100%	698	100%
Net Operating Expenditure				
- Companies with one quarter cash reserves	145	20%	147	21%
- Companies with two quarters' cash reserves	114	16%	116	17%
Administrative Expenditure				
- Companies with one quarter cash reserves	90	13%	81	12%
- Companies with two quarters' cash reserves	59	8%	54	8%

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

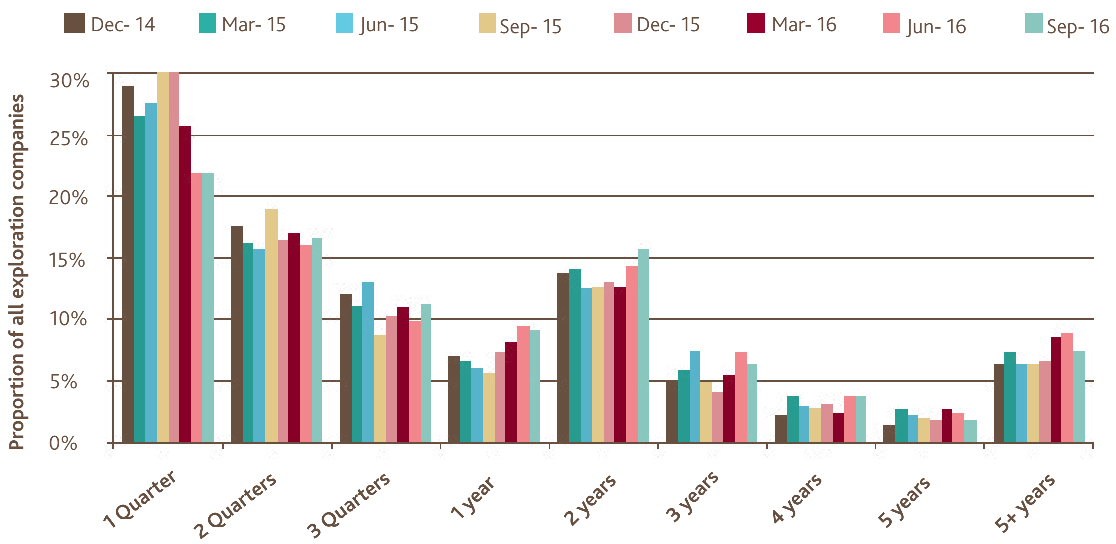
TOTAL EXPLORATION EXPENDITURE



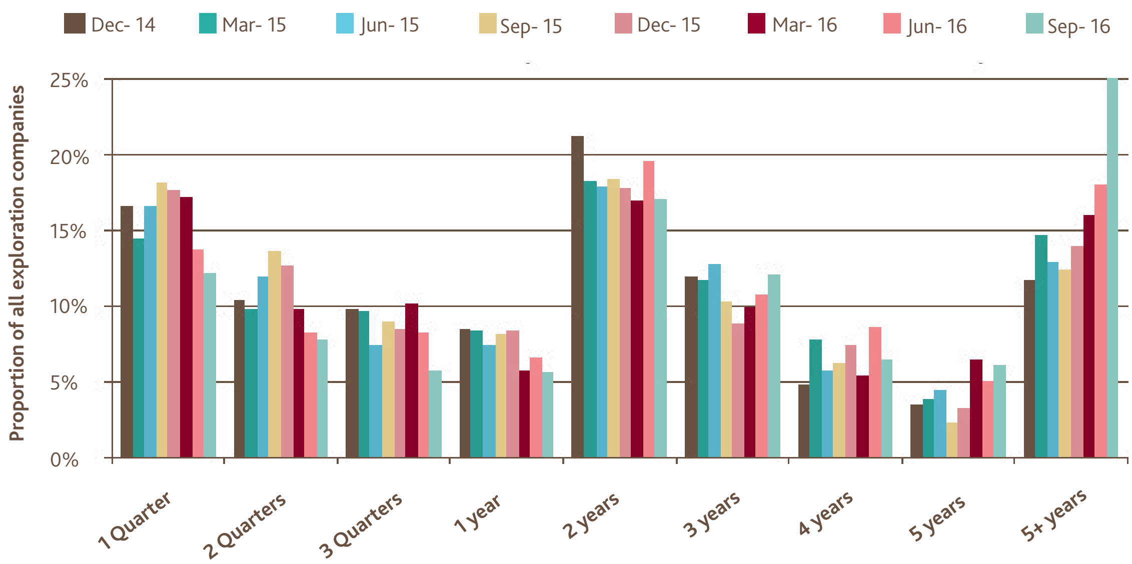
NET INVESTING CASH FLOWS



OPERATING EXPENSES - CASH BURN RATE



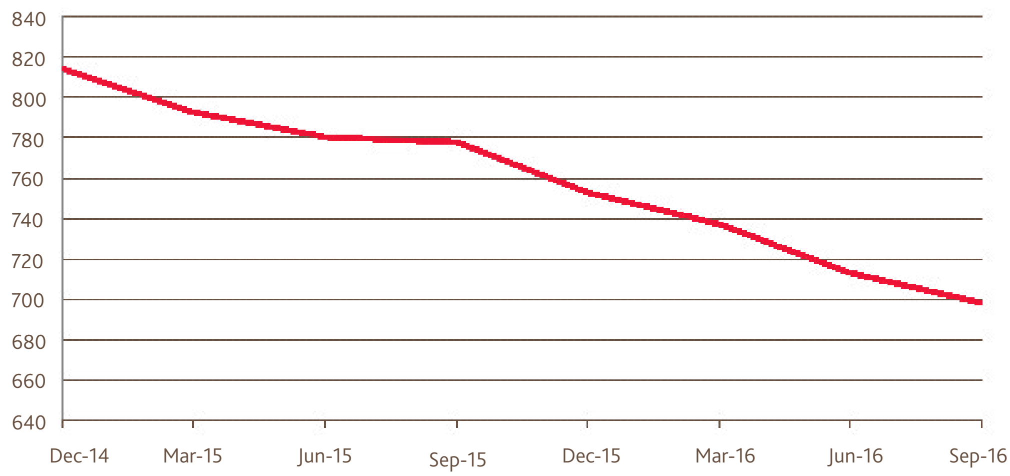
ADMINISTRATION EXPENSES - CASH BURN RATE



Points to note in relation to the above graphs are:

- The average exploration expenditure increased for the second consecutive quarter, from $418,000 for the June 2016 quarter to $451,000 for the September 2016 quarter. The median expenditure also increased from $115,000 to $135,000, which indicates that there has been a widespread increase in exploration expenditure, rather than just at the larger end of the market.
- In line with previous quarters, exploration expenditure of between $100,000 and $300,000 was the most common range for the September 2016 quarter. This accounted for 21.8% of the reporting companies, a decrease of 1.5% from the 23.3% for the June 2016 quarter. There was an increase in the percentage of companies that had exploration expenditure in excess of $300,000, from 29.2% in the June 2016 quarter to 34.0% in the September 2016 quarter.
- Based on the September 2016 quarter's operating cash flows, the percentage of companies that will burn through their cash reserves in the next quarter increased marginally, from 20.34% for the June 2016 quarter to 21.06% for the September 2016 quarter. Despite the increase, the number of companies that will burn through their cash reserves in the next quarter is significantly lower than the average of 27% exhibited over the year to March 2016. The increase, albeit small, bucks a downward trend in previous quarters, which has been attributable to exploration companies cutting back on expenditure in order to preserve cash reserves. Whilst this may still hold true for some companies, total exploration expenditure and operating expenditure for the September 2016 quarter increased, suggesting an improvement in industry sentiment.
- In relation to administration expenditure, 20% of companies have only one or two quarters of cash remaining (including companies with a negative cash balance) on current administration spend. This represents a 2% decrease from the 21% identified in the June 2016 quarter.

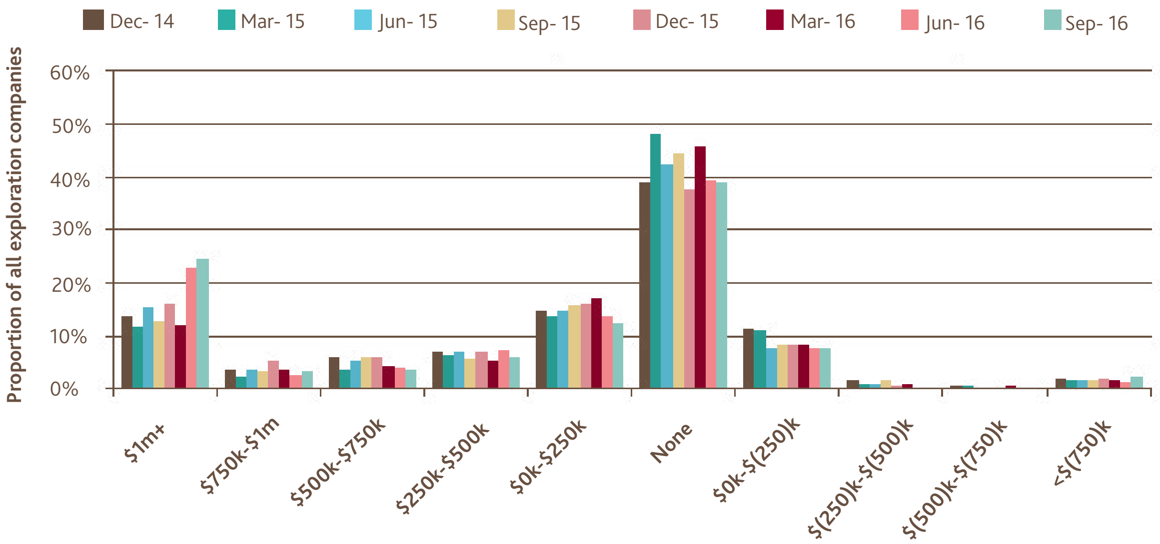
NUMBER OF COMPANIES LODGING APPENDIX 5B REPORTS: DECEMBER 2014 – SEPTEMBER 2016



- There has been a declining trend in the number of Appendix 5B lodgements over the years, with the number of companies lodging Appendix 5Bs decreasing to 698 in September 2016 from 713 in June 2016. This equates to a reduction of 2.15% for the September 2016 quarter.
- The number of companies lodging Appendix 5Bs has decreased by almost 20% over the last three and a quarter years, from 861 for the June 2013 quarter when we first conducted our analysis, to 698 for the September 2016 quarter.
- The net decrease from the June 2016 quarter to the September 2016 quarter of 15 companies was primarily a result of the following:
  - 9 companies were delisted during the quarter;
  - 4 companies were used as listing vehicles for backdoor listings, of which all were technology assets;
  - 3 companies are yet to lodge their Appendix 5Bs for the quarter;
  - 2 companies were suspended from quotation on the ASX, one was due to finalising a capital raising, the other was due to failing to lodge Full Year Accounts for the year ended 30 June 2016;
  - 1 company was in voluntary suspension due to the release of an announcement; and
  - 1 company was in administration.
- These reductions in the number of companies lodging Appendix 5Bs were partially offset by three new listings of exploration companies, one company that went into administration during the September 2016 quarter and one company lodged its Appendix 5B outside our analysis period for the June 2016 quarter.
- The primary reasons for the reduction in the number of companies lodging Appendix 5Bs per quarter over the last year are summarised in the table below:

	Sep-16	Jun-16	Mar-16	Dec-15
	No.	No.	No.	No.
Backdoor listings	4	14	14	14
Delisted	9	6	2	7
Suspended	3	7	0	1

NET FINANCING CASH FLOWS



- The proportion of exploration companies with positive financing cash flows decreased marginally from 51% for the June 2016 quarter to 50% for the September 2016 quarter. Furthermore, total net financing cash flows decreased by $473 million from the June 2016 quarter, with the average per company declining by $0.64 million. Despite the decrease, the ability of explorers to access debt and equity funding remains markedly higher than in periods prior to the June 2016 quarter

FUND FINDERS

The number of companies with nil financing cash flows for the quarter has remained constant at 39%. However, the average net cash inflows for the quarter have declined by $0.64 million, from $1.91 million for the June 2016 quarter to $1.27 million for the September 2016 quarter.

The number of companies that raised cash in excess of $10 million in the September 2016 quarter was 24, a decrease from 33 in the June 2016 quarter. Of these, 10 were gold companies, 4 were oil & gas companies, 4 were coal companies and 3 were copper companies. Gold stocks have continued to be favoured by the market due to the increased economic uncertainty stemming from the US Presidential Election. The companies that raised funds through either debt or equity are set out below:

- **Alkane Resources Limited** (multi-commodity) - $11.14 million proceeds from shares issued.
- **Altech Chemicals Limited** (alumina) - $11.00 million proceeds from shares issued.
- **Australis Oil & Gas Limited** (oil & gas) - $30.00 million proceeds from shares issued.
- **Blackham Resources Limited** (gold) - $25.00 million proceeds from shares issued, $0.41 million proceeds from the exercise of options and $8.00 million proceeds from borrowings.
- **Burey Gold Limited** (gold) - $11.83 million proceeds from shares issued.
- **Cardinal Resources Limited** (gold) - $21.75 million proceeds from shares issued and $0.17 million proceeds from the exercise of options.
- **Elk Petroleum Limited** (oil & gas) - $10.99 million proceeds from shares issued and $37.68 million proceeds from borrowings.
- **Empire Oil & Gas NL** (oil & gas) - $15.10 million proceeds from borrowings.
- **Finders Resources Limited** (copper) - $61.82 million proceeds from net hedge receipts.
- **Geopacific Resources Limited** (gold) - $11.28 million proceeds from shares issued.
- **Kibaran Resources Limited** (graphite) - $10.88 million proceeds from shares issued and $1.02 million proceeds from the exercise of options.
- **Kidman Resources Limited** (gold and lithium) - $16.13 million proceeds from shares issued and $4.87 proceeds from issue of shares not yet allotted.
- **Metro Mining Limited** (bauxite and coal) - $8.95 million proceeds from shares issued and $8.50 million proceeds from the exercise of options.
- **Prospect Resources Limited** (gold and lithium) - $17.11 million proceeds from shares issued.

- **Realm Resources Limited** (coal) - $49.48 million proceeds from borrowings.
- **Regal Resources Limited** (copper and cobalt) - $16.23 million proceeds from shares issued.
- **RTG Mining Inc** (gold) - $19.49 million proceeds from shares issued.
- **S2 Resources Limited** (gold and base metals) - $12.08 million proceeds from shares issued.
- **Sheffield Resources Limited** (mineral sands) - $17.13 million proceeds from shares issued.
- **Tigers Realm Coal Limited** (coal) - $21.01 million proceeds from shares issued.
- **Vimy Resources Limited** (uranium) - $6.26 million proceeds from shares issued and $7.50 million proceeds from borrowings.
- **West African Resources Limited** (gold and copper) - $21.00 million proceeds from shares issued.
- **WPG Resources Limited** (gold) - $13.67 million proceeds from shares issued, $0.94 million proceeds from the exercise of options and $1.21 million proceeds from a cash backed bond that was replaced by a bank guarantee facilitated by the joint venture partner, Diversified Minerals Pty Ltd.

As noted in previous editions, the market continues to favour gold in times of economic uncertainty, a sentiment that has been exacerbated by the US Presidential Election. This is evidenced by the fact that 10 of the 24 major fund raisings came from gold exploration companies during the September 2016 quarter.

The uncertainty stemming from the US Presidential Election and resultant investment in gold stocks, in conjunction with rallying commodity prices, has improved the economic viability of many projects. Furthermore, despite financing cash flows decreasing by approximately 33%, investor appetite for explorers with promising projects remains high relative to periods prior to the June 2016 quarter. Consequently, exploration companies have been less reluctant to invest funds in exploration and development of their projects.

Despite a noticeable improvement in industry sentiment and resultant increase in expenditure by exploration companies and their ability to attract funding, the December quarter is traditionally quiet, characterised by low levels of exploration and capital market activity as companies and brokers wind down towards the Christmas break. This is evidenced by the comparative estimated cash outflows by exploration companies at the same time last year. We note that the estimated cash outflows for the December 2015 quarter were almost 70% lower than the September 2015 quarter. Whereas in 2016, the December quarter estimate was only 9% lower than September. Therefore, we expect KPI's to decrease relative to the June 2016 and September 2016 quarters, however we consider the depressed figures to be a result of this seasonal trend and not reflective of the market itself.

BDO INSIGHT

BDO was one of a number of respondent's to the ASX consultation paper on the changes to the listing rules. One of our key messages to the ASX was to have a carve out for exploration companies, whilst the ASX did not adopt such a position a number of their proposed changes were softened, in effect meeting the requests halfway. The impact of the listing rule changes has certainly led to a slowdown of tech RTOs however, we have seen some resources IPOs so overall we believe an appropriate position has been adopted.

BDO Remuneration and Reward is undertaking a resources labour productivity survey to benchmark labour cost and labour deployment against performance. In order to do this we have isolated a number of labour productivity levers which impact upon profitability, growth and sustainability. This includes labour costs, management structures, staff numbers and seniority. Performance will be measured in terms of 'annual production targets against budget' and 'total cost target against budget'. This may seem simplistic however the simplicity allows us to identify and benchmark what similar organisations are doing to determine best practice and reduce the burden of completing the survey to ensure we get a high degree of participation. The survey results will be provided to participants in a format that will not disclose the details of individual participants.

Further information on the survey will be provided at an information session, 'BDO Labour Productivity Survey Information Session', on 9 December 2016.

For further information on BDO Remuneration and Reward click here to download an information flyer.

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