Q2 – EXPLORER QUARTERLY CASH UPDATE

RESEARCH INTO THE FINANCIAL HEALTH OF AUSTRALIAN-LISTED EXPLORERS: Q2 (QUARTER ENDED 31 DECEMBER 2016)

EXPLORATION EXPENDITURE INCREASES FOR THIRD SUCCESSIVE QUARTER

- **INVESTOR APPETITE FOR GOLD DECLINES AS STRONG PERFORMING US ECONOMY ALLEVIATES UNCERTAINTY STEMMING FROM US PRESIDENTIAL ELECTION**
- **AVERAGE ESTIMATED CASH OUTFLOWS FOR THE NEXT QUARTER CONTINUE TO INCREASE**
- **M&A ACTIVITY REAFFIRMS IMPROVED INDUSTRY SENTIMENT**

BDO's report on the cash position of Australian-listed explorers for the December 2016 quarter (based on quarterly Appendix 5B reports lodged with the ASX), shows that there has been continued growth in total exploration expenditure, despite a persistent decline in the number of companies reporting. The average estimated cash outflows for the next quarter (March 2017) were almost 40% higher than estimates for the same period last year, indicating that industry sentiment is improving and that the trend of increasing exploration activity is likely to continue.

For the quarter ended 31 December 2016, 690 companies lodged an Appendix 5B report, which was eight less than the 698 to lodge in the September 2016 quarter and 63 less than the 753 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.

Despite a decline in the number of reporting companies, total exploration expenditure increased for the third successive quarter after more than two years of sustained decreases. Furthermore, the average estimated cash outflows for the December 2016 quarter increased by 13% from estimates in the September 2016 quarter. The increase in funds committed to exploration and estimated future expenditure reaffirms the improvement in industry sentiment, which was first identified in the June 2016 quarter.

Six exploration companies conducted IPOs during the December 2016 quarter, an increase from the three during the September 2016 quarter and two during the June 2016 quarter.

A summary of the IPOs from the December 2016 quarter is presented in the table below:

COMPANY	COMMODITY	AMOUNT RAISED ($)
Blackstone Minerals Ltd	Gold and Nickel	3,500,000
Davenport Resources Ltd	Potash	5,111,737
Great Boulder Resources Ltd	Gold	6,144,100
Horizon Gold Ltd	Gold	15,000,000
Kalium Lakes Ltd	Potash	6,000,000
Technology Metals Australia Ltd	Vanadium	4,000,000

Total net financing cash flows declined by 19% during the quarter, from $888 million in the September 2016 quarter to $722 million for the December 2016 quarter. As evidenced in previous years, a decline in financing activity for the December quarter is not uncommon, as companies typically defer capital raisings until the March quarter. Despite the decline, we note that there was still an appetite for large capital raisings during the quarter, with Kore Potash Limited and Berkeley Energia Limited raising $61.9 million and $39.7 million, respectively.

Gold and oil & gas stocks continued to receive significant financing cash flows, with four gold and three oil & gas companies raising in excess of $10 million during the December 2016 quarter. However, the interest in gold has declined significantly since the September 2016 quarter, during which, 10 gold companies raised in excess of $10 million on the back of heightened economic uncertainty that arose during the quarter due to the US Presidential Election.

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Since the Trump Government won the US Presidential Election on 8 November 2016, investor uncertainty has dissipated and the US economy has exhibited strong growth. The Dow Jones Industrial Average increased by 13.6% between 8 November 2016 and the end of February 2017, with other major exchanges from around the world following suit, including the ASX 200 which increased by almost 9% over the same period. This supports the old adage that when the US market sneezes, Australia catches a cold.

The growth exhibited by the US and Australian economies indicates that investors' uncertainty regarding the US Presidential Election and its impact on the global economy appears to have been somewhat alleviated. Consequently, we have observed a redirection in the demand for gold stocks towards other higher yielding equities, including other commodities. This transition in investor appetite is illustrated by an increase in financing cash flows for lithium, uranium and potash stocks, which was highlighted by Kore Potash Limited raising $61.85 million from the issue of shares during the December 2016 quarter.

The average cash balance of exploration companies increased by $0.52 million for the quarter, from $5.68 million for the September 2016 quarter to $6.20 million at 31 December 2016. The increase was primarily as a result of Gold Road Resources Limited selling 50% of its Gruyere Gold Project to Gold Fields Limited for $250 million. The willingness of Gold Road Resources to sell its proven asset to an established gold producer and use the proceeds to continue exploration, signals further improvement in industry sentiment and suggests a positive outlook.

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

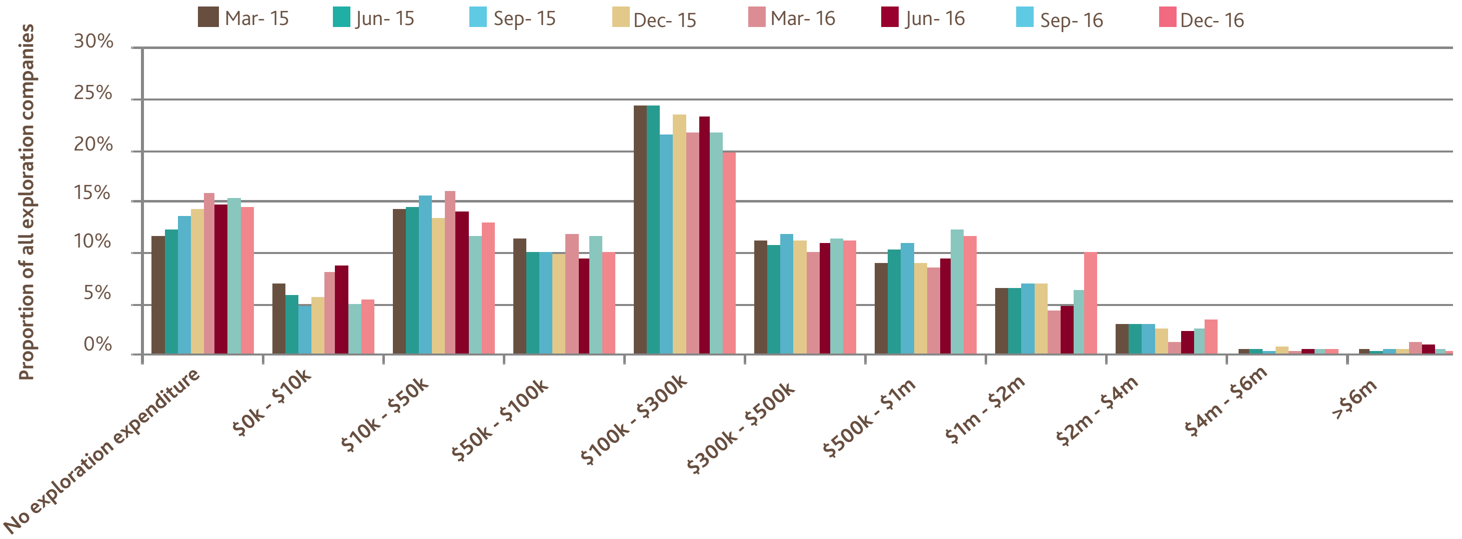
- The average exploration expenditure increased for the third successive quarter, from $0.45 million in the September 2016 quarter to $0.51 million in the December 2016 quarter. This indicates that the previous trend of declining exploration expenditure, and cash preservation is well and truly reversing.
- In the December 2016 quarter, 690 companies lodged Appendix 5B reports, a decline from the 698 companies that lodged reports in the September 2016 quarter.
- Reasons for the reduction included 11 companies being the subject of backdoor listings, seven of which were technology related companies, and five companies being delisted, suspended or entering administration. These were partially offset by the addition of six exploration companies that conducted an IPO during the quarter.
- The number of companies that raised in excess of $10 million in the December 2016 quarter was 18, down six from the 24 in the September 2016 quarter. Of the $903 million in financing cash inflows for the December 2016 quarter, these 18 companies accounted for $402 million, approximately 45%.
- The proportion of companies with two or more years of cash reserves, based on current operating expenses, increased from 25% for the September 2016 quarter to 46% for the December 2016 quarter. This increase is largely the result of an increase in cash reserves over the analysis period. Additionally, with the declining number of exploration companies reporting, we have observed that the companies exiting the industry typically have less than one year of cash reserves, based on current operating expenses. Consequently, the remaining companies with more than one year of cash reserves account for a larger proportion of the total exploration companies.
- Net investing cash flows transitioned from a net outflow of $102 million for the September 2016 quarter to a net inflow of $150 million for the December 2016 quarter. The difference was primarily attributable to Gold Road Resources' aforementioned sale of the Gruyere Project for $250 million.
- Despite the change in net investing cash flows from a net outflow to a net inflow, the proportion of explorers with a net investment in capital expenditure increased from 37.5% for the September 2016 quarter to 40.0% for the December 2016 quarter.
- Investor appetite for gold stocks reduced over the quarter as a strong performing US economy alleviated uncertainty stemming from the US Presidential Election and its impact on the global economy.

DECEMBER 16 QUARTER CASH POSITION

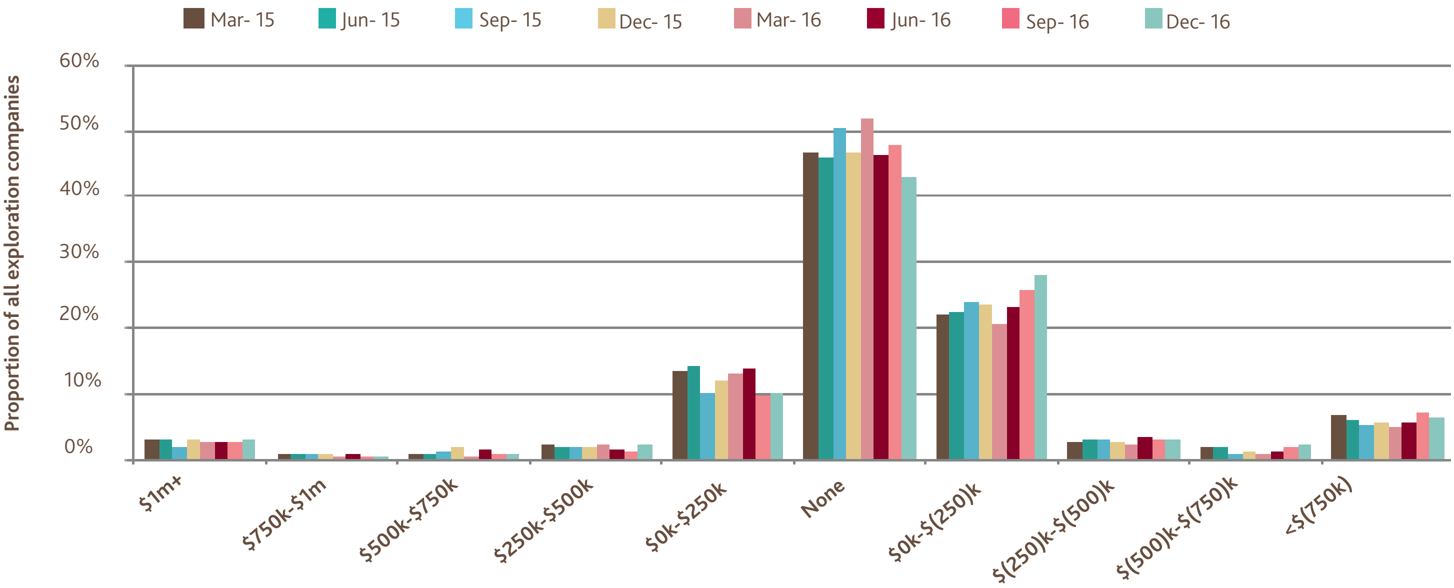
	DECEMBER 16 QUARTER		SEPTEMBER 16 QUARTER	
	No.	%	No.	%
Total number of companies lodging Appendix 5Bs	690	100%	698	100%
Net Operating Expenditure				
- Companies with one quarter cash reserves	144	21%	153	22%
- Companies with two quarters' cash reserves	259	38%	269	39%
Administrative Expenditure				
- Companies with one quarter cash reserves	65	9%	85	12%
- Companies with two quarters' cash reserves	116	17%	139	20%

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

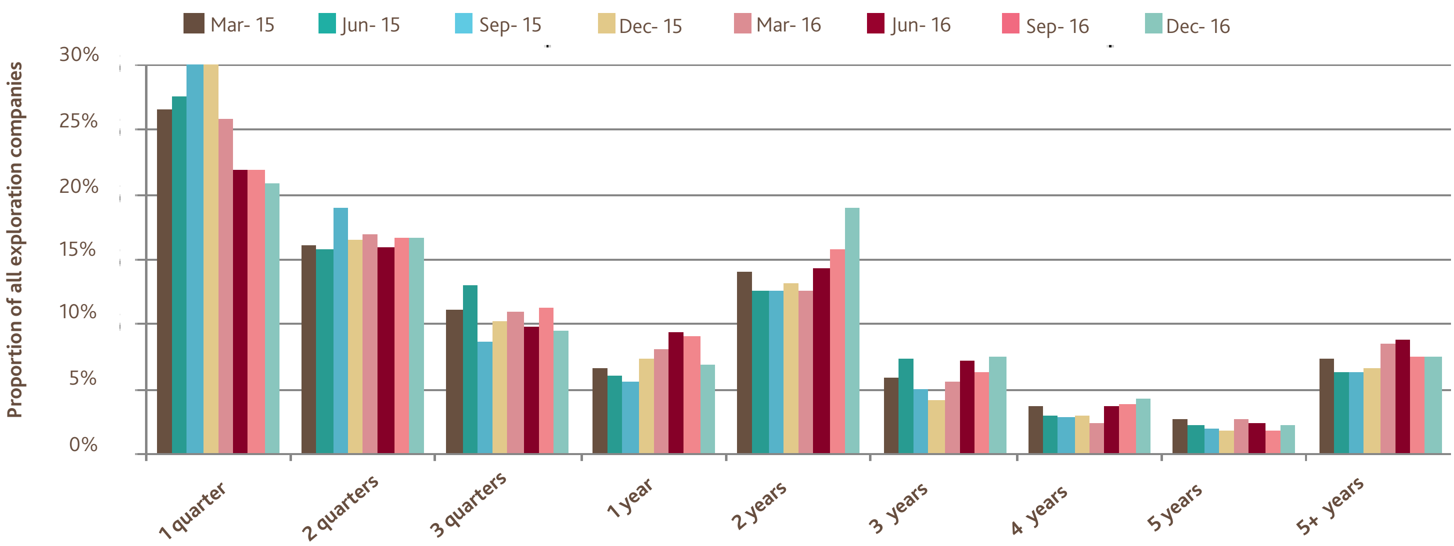
TOTAL EXPLORATION EXPENDITURE



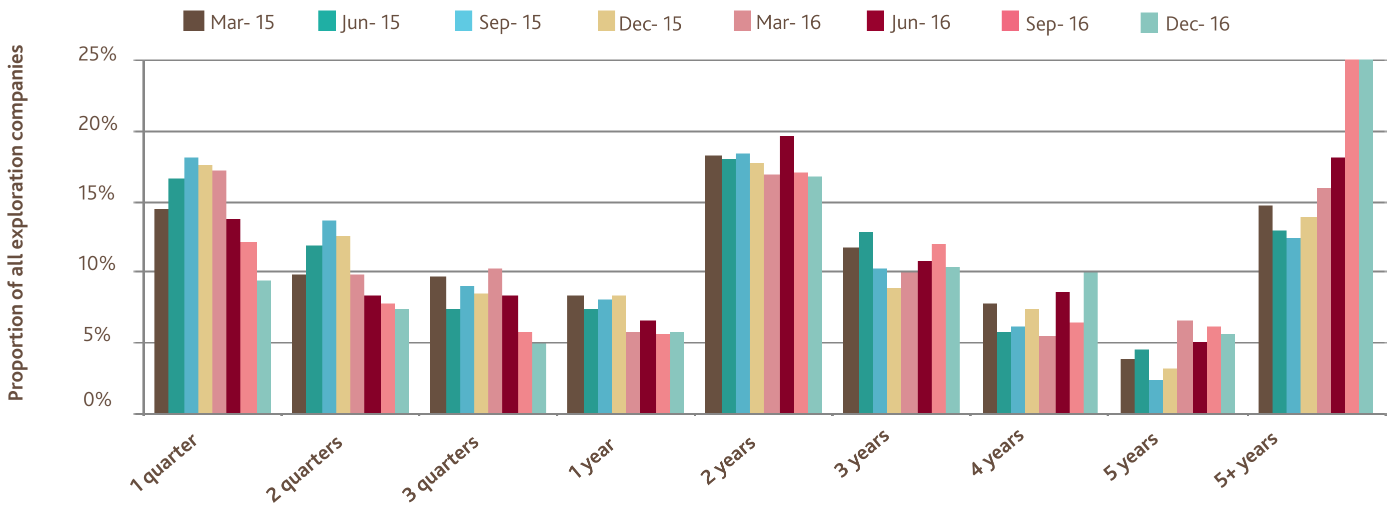
NET INVESTING CASH FLOWS



OPERATING EXPENSES - CASH BURN RATE



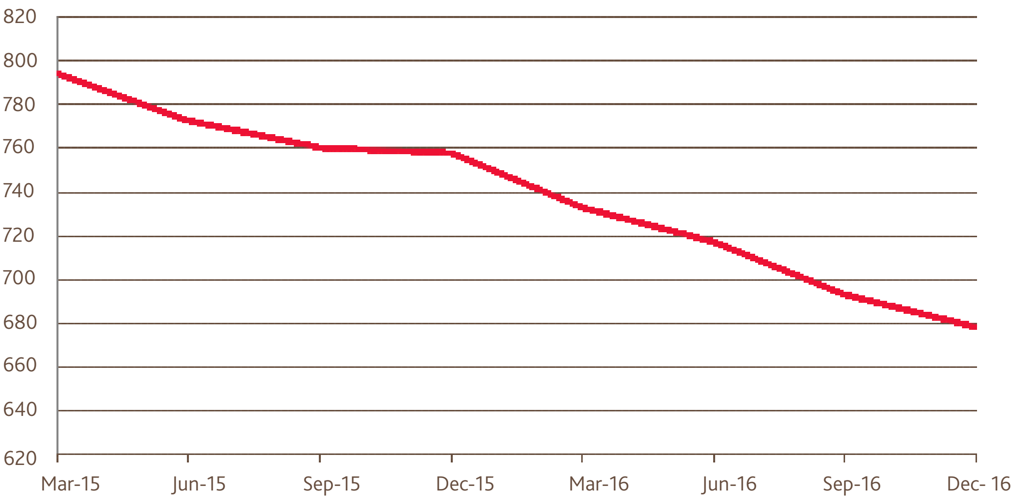
ADMINISTRATION EXPENSES – CASH BURN RATE



Points to note in relation to the above graphs are:

- The average exploration expenditure increased for the third consecutive quarter, from $0.45 million for the September 2016 quarter to $0.51 million for the December 2016 quarter. The median expenditure also increased from $0.13 million to $0.16 million, 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 $0.10 million and $0.30 million was the most common range for the December 2016 quarter. This accounted for 19.7% of the reporting companies, a decrease of 2.1% from the 21.8% for the September 2016 quarter. There was an increase in the percentage of companies that had exploration expenditure in excess of $0.3 million, from 34.0% in the September 2016 quarter to 37.4% in the December 2016 quarter.Net investing cash flows transitioned from a net outflow of $102 million for the September 2016 quarter to a net inflow of $150 million for the December 2016 quarter. The difference was primarily attributable to Gold Road Resources aforementioned sale of the Gruyere Project for $250 million.
- Based on the December 2016 quarter's operating cash flows, the percentage of companies that will burn through their cash reserves in the next quarter decreased marginally, from 21.1% for the September 2016 quarter to 20.6% for the December 2016 quarter. The number of companies that will burn through their cash reserves in the next quarter is significantly lower than the average of 27.5% exhibited over the year to December 2015. The fact that the number of explorers that will burn through their cash reserves in the next period continues to decline despite exploration expenditure increasing, further endorses an improvement in industry sentiment.
- The proportion of companies with two or more years of cash reserves, based on current operating expenses, increased by 21% during the December 2016 quarter. This increase is largely the result of an increase in cash reserves coupled by a reduction in operating expenses. Additionally, we have observed that the companies exiting the industry are typically characterised as having less than one year of cash reserves, based on current operating expenses. Consequently, the remaining companies with more than one year of cash reserves account for a larger proportion of the total exploration companies.
- In relation to administration expenditure, 17% 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 3% decrease from the 20% identified in the September 2016 quarter.
- Total administration expenditure increased from $195 million for the September 2016 quarter to $213 million for the December quarter, which is in line with our expectations given the increase in exploration activity observed over the quarter.

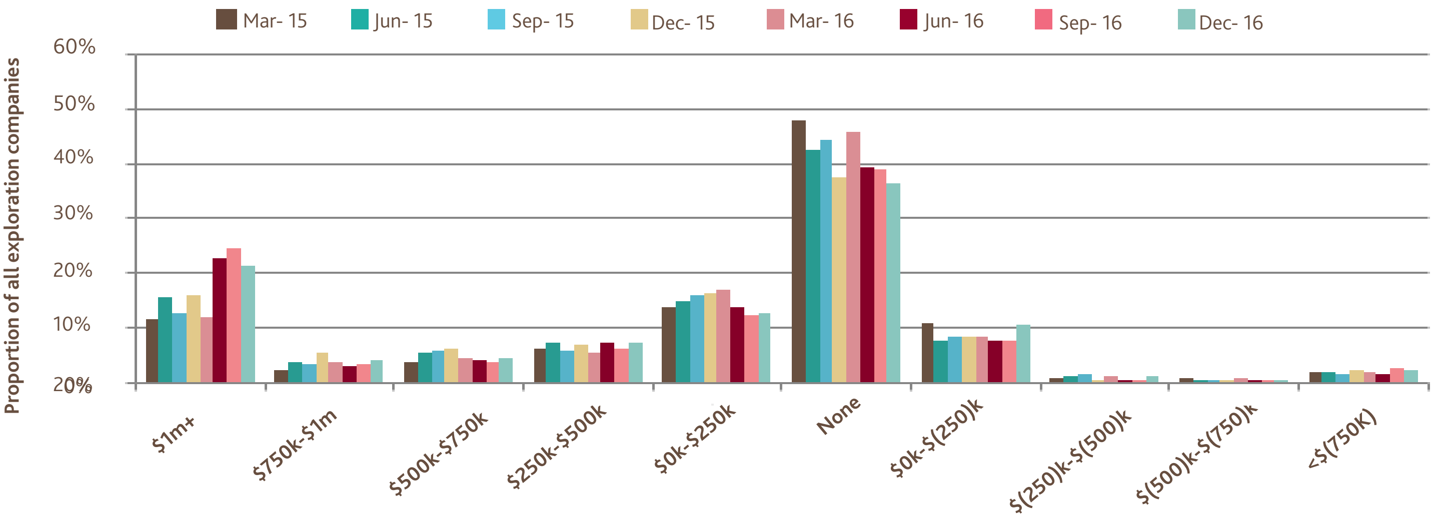
NUMBER OF COMPANIES LODGING APPENDIX 5B REPORTS: MARCH 2015 – DECEMBER 2016



- 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 690 in December 2016 from 698 in September 2016.
- The number of companies lodging Appendix 5Bs has decreased by almost 20% over the last three and a half years, from 861 for the June 2013 quarter when we first conducted our analysis, to 690 for the December 2016 quarter.
- The net decrease from the September 2016 quarter to the December 2016 quarter of nine companies was primarily a result of the following:
  - 11 companies were used as listing vehicles for backdoor listings, of which seven were technology assets;
  - 2 companies were suspended from quotation on the ASX, one was due to its operations not being deemed sufficient as per ASX Listing Rule 12.1, the other was voluntarily suspended pending the release of a proposed acquisition announcement;
  - 2 companies were delisted during the quarter;
  - 1 company was in administration;
  - 1 company was the subject of a friendly takeover; and
  - 1 company transitioned to production and no longer releases an Appendix 5B.
- These reductions in the number of companies lodging Appendix 5Bs were partially offset by six new listings of exploration companies, two companies that lodged their Appendix 5Bs outside our analysis period for the September 2016 quarter and one company that was suspended during the September 2016 quarter before being reinstated in the December 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:

	Dec-16 No.	Sep- 16 No.	Jun-16 No.	Mar- 16 No.	Dec- 15 No.
Backdoor listings	11	4	14	14	14
Delisted	2	9	6	3	7
Suspended	2	3	7	5	1

NET FINANCING CASH FLOWS



- The proportion of exploration companies with positive financing cash flows decreased marginally from 50% for the September 2016 quarter to 49% for the December 2016 quarter. Furthermore, total net financing cash flows decreased by $167 million from the December 2016 quarter, with the average per company declining by $0.22 million.
  Despite the decrease, we note that there was still an appetite for large capital raisings during the quarter, as evidenced in our fund finders analysis below.

FUND FINDERS

The proportion of exploration companies with nil financing cash flows for the quarter decreased from 39% for the September 2016 quarter to 36.4%. However, the average net cash inflows declined by $0.22 million, from $1.27 million for the September 2016 quarter to $1.05 million for the December 2016 quarter.

The number of companies that raised cash in excess of $10 million in the December 2016 quarter was 18, a decrease from 24 in the September 2016 quarter. Of these, four were gold companies, three were oil & gas companies, and two were lithium, uranium and coal companies. Investor appetite for gold stocks has dissipated over the December 2016 quarter as a strong performing US economy appeased uncertainty stemming from the US Presidential Election. New found investor confidence has seen a redirection in the demand for gold stocks towards other higher yielding equities, including other commodities.

The companies that raised funds in excess of $10 million through either debt or equity are set out below:

- **88 Energy Limited** (Oil & Gas) - $11.0 million proceeds from shares issued.
- **Atrum Coal Limited** (Coal) - $13.8 million proceeds from shares issued.
- **Berkeley Energia Limited** (Uranium) - $39.7 million proceeds from shares issued.
- **Breaker Resources NL** (Gold) - $12.4 million proceeds from shared issued.
- **Dacian Gold Limited** (Gold) - $26.5 million proceeds from shares issued.
- **Elk Petroleum Limited** (Petroleum) - $20.0 million proceeds from borrowings.
- **Finders Resources Limited** (Copper) - $12.0 million proceeds from shares issued and $0.68 million from proceeds of convertible notes issued.
- **Galaxy Resources Limited** (Lithium) - $16.0 million proceeds from borrowings and $0.75 million proceeds from options exercised.
- **Horizon Gold Limited** (Gold) - $15.0 million proceeds from shares issued.
- **Kore Potash Limited** (Potash) - $61.9 million proceeds from shares issued.
- **Lithium Power International Limited** (Lithium) - $13.5 million proceeds from shares issued.
- **Metminco Limited** (Copper) - $11.0 million received on acquisition of Compania Miraflores Equity funding and $1.22 million proceeds from shares issued and options exercised.
- **Metro Mining Limited** (Coal) - $40.0 million proceeds from borrowings and $0.3 million from options exercised.
- **MZI Resources Limited** (Mineral Sands) - $21.5 million proceeds from borrowings.
- **Nido Petroleum Limited** (Oil & Gas) - $27.4 million proceeds from shares issued.
- **Peninsula Energy Limited** (Uranium) - $8.9 million proceeds from shares issued and $9.7 million proceeds from borrowings.
- **Red River Resources Limited** (Zinc) - $14.0 million proceeds from shares issued and $0.35 million from options exercised.
- **Wolf Minerals Limited** (Tungsten) - $23.9 million proceeds from borrowings.

BDO INSIGHT

Looking forward, we note the intentions of many companies to increase their expenditure, which highlights the positive industry sentiment. It is welcome to see the return of exploration company IPOs during the last quarter. This has continued in the March 2017 quarter with companies such as Blackstone Minerals Limited and Matador Mining Limited successfully listing in early 2017. We anticipate that we will see an increase in the number of exploration IPOs during 2017.

Another feature we are likely to see more of in 2017 will be spin offs of non-core assets by way of IPO. We have already seen some recent examples such as:

- **Ardea Resources Limited** being spun out of Heron Resources Limited;
- **Cobalt Blue Holdings Limited** being spun out of Broken Hill Prospecting Ltd;
- **Marquee Resources Limited** being spun out of Sovereign Gold Limited; and
- **Todd River Resources Limited** being spun out of TNG Limited.

Given the success of these transactions we expect that we will see many more such spin offs throughout 2017.

It is even possible that we may see a reversing of the trend of exploration shells being used as vehicles for reverse takeovers by technology companies. Don't be surprised if in 2017 we start to see exploration projects being reversed into technology shells!

MORE INFORMATION

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