Grant Thornton

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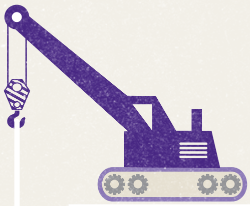
INDUSTRY POSITION SURVEY | OCTOBER 2015

JUMEX Survey

The annual survey of junior mining and exploration companies

2015



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JUMEX Foreword

Simon Bennison

AMEC, Chief Executive Officer

The Association of Mining and Exploration Companies (AMEC) is pleased to once again present the Foreword to the Grant Thornton JUMEX Survey. Grant Thornton's annual survey provides insight into the mineral exploration industry across Australia and the key issues facing junior miners and explorers.

The survey results highlight the top five challenges facing companies with the number one constraint being the lack of equity finance for this sector. This has been the number one constraint for the past three years. However, only 15% of respondents are seeing some signs of improved investor interest.

Deterioration of company share price and volatility of commodity prices are ranked in second and third place respectively. General stability of financial markets has moved up from fifth place in 2014 to fourth place in 2015 with the uncertainty in the global markets. Regulatory challenges remains in the top five business constraints, now ranked fifth.

Despite these challenges companies have continued to demonstrate their resilience and ability to overcome the circumstances to achieve some impressive results. Whilst the number of new major discoveries is declining, some companies are proving the value of investing in exploration by generating some significant results and value for money.

AMEC
ASSOCIATION OF MINING AND EXPLORATION COMPANIES

Gold Road Resources are one such example. Ziggy Lubieniecki, Kyle Prentice and Justin Osborne from Gold Road Resources were awarded the AMEC Prospector Award this year for the Gruyere Gold Project. The discovery - from start to finish - was made in just 12 months at a very low cost. High quality geological modelling and extensional targeting enabled the low cost discovery. Ongoing drilling is providing extremely promising results.

On another positive note the survey has revealed a trend in recent years for companies to refocus on Australia for future project acquisitions. Eighty nine per cent of respondents considering acquisitions have Australia in their shortlist, followed by Africa (19% of respondents considering acquisitions).

Australia is also proving to be relatively attractive for investment with 74% of respondents having received an approach or conducted a transaction with overseas investors. Hopefully this translates into increased investment in mineral exploration since exploration is at its lowest levels in the past ten years. Greenfields mineral exploration is essential to discover the mines of tomorrow.

AMEC has been the leading advocate for the Exploration Development Incentive (EDI) which is now available for eligible greenfield mineral exploration projects in Australia. At this point, funding for the EDI is available for three years. We need to ensure that the uptake of the EDI is successful in order to seek extension of the program beyond this timeframe. AMEC has proposed a number of changes to the EDI to simplify its administration.

Whilst there have been some positive policy changes such as the repeal of the mining and carbon taxes last year and the introduction of the EDI, there is still a lot more to be done. Twenty five per cent of respondents cited regulatory constraints as a major impediment to business during FY15. The most notable being land access issues, delays or challenges in obtaining environmental approvals, and delays or challenges on the granting of exploration permits or exploration licences.

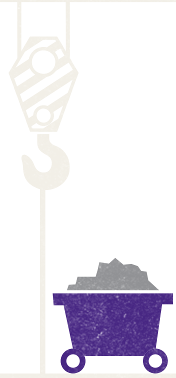
AMEC has been working with the State, Territory and Federal Governments to streamline approval processes, improve timeframes, reduce costs, increase exploration and encourage investment. AMEC continues to be the leading advocate for companies on policy changes that will make Australia an attractive, safe and stable investment destination.

Simon Bennison
AMEC, Chief Executive Officer

Executive sponsor

Holly Stiles

National Head of Energy & Resources, Grant Thornton Australia



We are pleased to present the findings from our sixth annual survey of junior mining and exploration companies (JUMEX). This research forms part of our ongoing commitment to independent industry insight and our focus on junior resource companies.

It almost goes without saying that FY15 was yet another extremely challenging year for JUMEX companies. While mining is a cyclical industry with periodic highs and lows, many in the industry agree that conditions are as tough as have ever been seen, not just in Australia, but globally.

Of course, some companies have been successful despite market conditions. Sirius Resources is the brightest example, having risen from a small JUMEX company with greenfields exploration assets in July 2012 to being taken over by the Independence Group NL in September 2015 at a point where construction of its flagship Nova project is progressing at a rapid rate. There are many others that have achieved strong success in developing projects and attracting finance despite market conditions and those companies must be highly commended.

However, of the over 700 JUMEX companies in Australia, the majority are not faring as well. Years of cash constraints, falling share prices, volatile commodity prices and disgruntled shareholders have taken their toll. The demands of capital raising in this market are a significant drain on management time, with three quarters of respondents that had a fund raising need in FY15 experiencing moderate or significant challenges in securing capital (2014: 79%).

The number of companies surviving on very low cash balances is increasing, with 29% of companies having less than $500,000 of cash. At such low cash levels the opportunities for management to develop projects and add value is very limited and survival is a key priority. Some companies may be able to ride out another year or two with minimal expenditure; however, for those with slim cash reserves and smaller hopes of a successful future fundraising (nearly two thirds of respondents see no sign of improvements in investor interest in JUMEX companies this financial year), the time may have arrived to make some hard decisions.

Backdoor listings into mining-shells have increased significantly over the last year and, whilst it would not be the outcome any mining executive would hope for, such transactions may present an opportunity for directors to provide some ongoing value to shareholders when all other opportunities for the company's resource projects have been exhausted.

Commodity prices have taken hits across the board over the past year and this volatility has again presented a major constraint to business. In terms of the outlook, of course some commodities are more attractive than others. There is strong consensus from our respondents that gold is the commodity offering the greatest opportunity over the next 12 month and we are seeing relatively strong interest in gold projects from a variety of investors.

In the current environment, making the most of every dollar spent is critical and there are a wide range of new and interesting technologies that can assist. We strongly believe that innovation and technological developments are crucial for the survival and future success of the mining industry. We have also been encouraged to see various examples of strong collaboration between JUMEX companies and mining service providers. We encourage JUMEX companies to seek such opportunities and other creative and innovative ways to add value to projects and generate a return for shareholders.

Our JUMEX survey seeks the views of the industry's senior executives on a range of issues, providing a comprehensive, independent industry snapshot.

Grant Thornton would like to express our appreciation to those who participated in the survey.

Top 10 key findings

The JUMEX sector accounts for approximately 35% of all ASX listed companies and is therefore a significant portion of the market. However, unfortunately it seems likely that there will be increasing fallout from the ongoing lack of investor support for the sector.

Following years of constrained equity financing, exploration activities levels are low and are declining, which is a significant concern for the future of the industry. It is imperative that the broader industry collaborates and innovates to find ways to identify and exploit resources in the most efficient way to restore investor confidence and to identify the mines of tomorrow.

The top 10 findings of our 2015 JUMEX survey are:

01 **Funding, funding, funding**

The almost complete lack of accessible funding is persistently the most significant issue impacting all but those companies with particularly attractive assets and exceptional management. The vast majority of JUMEX companies have been bereft of any meaningful funding for several years, significantly hampering their ability to progress projects and add shareholder value.

02 **Competition for capital**

With half our respondents planning a fund raising within 6 months (2014: 45%) and 29% of respondents having a cash balance of less than $500,000 competition for capital remains extremely fierce and unfortunately there appear to be few positive signs of any improvement in investor interest in the short term.

03 **Search for investors more global than ever**

Funding constraints push explorers to seek capital from global market to expand the potential pool of investors. While investor interest in the mining sector is constrained globally, there are pockets of investors willing to fund attractive projects and companies must work harder than ever to source them.

04 **Failure and consolidation expected**

Unfortunately we foresee an increased number of business failures, consolidations and sector exits (e.g. through back door listings) over the next two years. With such low investor interest, it seems unlikely that the market will continue to sustain over 700 listed JUMEX companies.

05 A burning platform drives innovation

The drive and competitive nature of Australian explorers ensures they persist and continue to collaborate with others (mining services and producers) to develop innovative responses to current challenges. With technology playing an increasing role, cost-cutting and operational efficiency is no longer enough. JUMEX companies need to embrace new technologies to maximise results from activities they undertake and must be ever more creative in structuring solutions to fund and develop their projects.

06 The future of Australia's mining industry

Exploration activity is low and falling due to the severe capital shortage, compounded by management teams reluctant to invest precious cash in exploration, particularly when markets repeatedly fail to recognise successful results. As a result, metres drilled are at a low point, with ABS data showing exploration expenditure at roughly the same point it was nine years ago and expenditure levels for exploration lower than10 years ago. The bottom line is that explorers are exploring less and less each year.

07 Regulatory challenges persist

Land access delays and the difficulty in obtaining environmental approvals, permits and mining licences remain a concern. State and federal government bodies need to prioritise removing all such impediments to an industry already severely challenged.

08 Refocus on Australia

While many of our respondents do have global operations and will continue to do so, these tougher times bring added complexity, cost and risk to exploration activities located elsewhere and a number of companies have been burnt by experiences overseas. There is therefore a strong trend to refocus on Australia for future project opportunities.

09 Ongoing commodity pricing pressures

Commodity price volatility has again been a major constraint to business in FY15. Whilst our survey respondents are generally optimistic about pricing for the key commodity of their flagship project, analyst forecasts are not so positive. There are positive signs for a few commodities, however many face ongoing challenges and the potential for further falls, which will not assist JUMEX companies in their future funding raising efforts.

10 Employment to remain at low levels

Explorers are mostly expecting to keep employment numbers unchanged. Geologists in particular continue to face high unemployment levels.

The external environment

Economic commentary is kindly supplied by *ANZ.*

Macro outlook

As global trade splutters, China's momentum weakens and commodity prices remain near cyclical lows, expectations for economic growth for 2016 and 2017 continue to be lowered. The main weakness is in emerging markets (EM). Many of the EM commodity exporters have been in or near recession for the past year. The arithmetic alone means global growth is highly vulnerable to weaker EM growth as these economies now make up about half of world output. China is just under 20% of the world economy alone.

It is more than just the arithmetic. The EM countries have been an important source of growth since the financial crisis of 2007-09. Initially it was the huge fiscal stimulus, particularly in China, that gave global trade and activity a lift. More recently it has been a significant leveraging of EM corporate balance sheets that has helped support growth. These factors are now less powerful or even in retreat. We do not expect a major EM slowdown at this stage but even a modest one will make it hard to get any lift in overall global growth in the next few years.

With the fast growing parts of the world economy slowing down a bit and the advanced economies unable to generate much growth, the overall world economy is expected to remain stuck in a 3 to 3.5% growth range for the foreseeable future. We struggle to see how growth can accelerate in the next few years. The US economy is running out of spare capacity while Europe and Japan still face substantial structural headwinds and deflation risks. The prospect of a significant rise in leverage in the advanced economies is dim given already high debt levels and ageing populations.

The emerging world holds the key to the global growth outlook over the next few years. On this front all the risks appear skewed to the downside, in particular in China. The Chinese economy is slowing, and in our opinion will continue to slow towards annual growth of 6% by 2017. However, any sudden weakening in growth will be met with both monetary and fiscal stimulus.

The extent to which financial problems arise in emerging economies as growth slows will be a key determinant of the extent of the impending global slowdown. More specifically, a surge in financial distress can turn a soft global economic outlook into a global economic downturn fairly quickly. Financial markets and investors will be on high alert for these risks, constraining risk appetite even as liquidity remains abundant.

This means that growth in the world economy will be stuck in this tight 3% to 3.5% as it has been for the past three years.

Commodities outlook

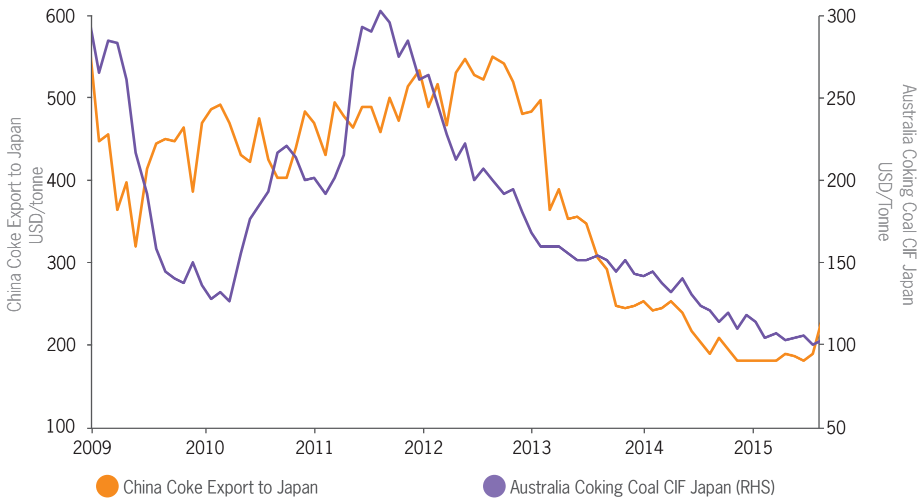
Iron ore prices have traded in a wide 30% range in the past two months as nervousness around the Chinese economy waxes and wanes. Prices have stabilised around the mid US$50/tonne range, but we think there is more downside risk in the short term. Our concerns revolve around the timing of slowing Chinese steel demand while the seaborne iron ore supply continues to rise. Australian and Brazilian iron ore exports are increasing, which is being reflected in rising robust Capesize freight rates. The drag for prices is that demand is unlikely to soak up the additional supply. Chinese steel mills are extending annual maintenance programs in light of weak demand conditions. Expect seaborne prices to breach US$50/tonne and trade in the higher US$40/tonne range in the coming months.

While ***coking coal*** prices look very weak, the dynamics may be about to change. Underlying demand conditions are unlikely to improve, but supply-side headwinds appear to be passing. Sinking Chinese coal imports, down 30% since the start of the year, have turned. Chinese coking coal imports in June jumped 170% to 5.1 million tonnes, the largest monthly increase since December. However, flat steel output over the same period suggests Chinese coking coal supply is declining. Competing Chinese coke exports have also dipped heavily in recent times. In fact, the profitable arbitrage with coking coal has reverted (Figure 3), suggesting consumers would prefer to import unrefined coking coal in the near term. As a result, we think spot prices should start to recover into the mid to high US$80/tonne range.

Figure 1: Baltic Capesize Freight rates

Source: Bloomberg, ANZ Research

Figure 2: Coking coal & Coke prices

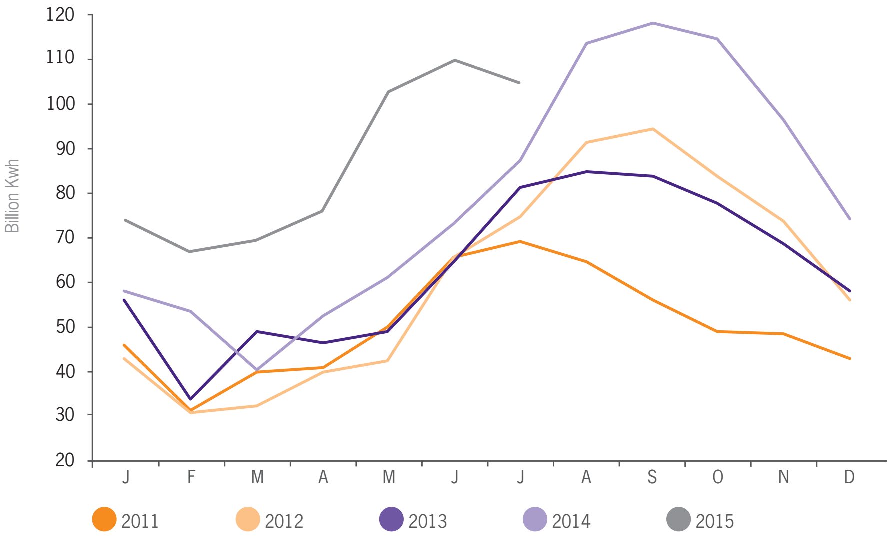


Source: Bloomberg, ANZ Research

Thermal coal appears to be holding up a little better, but stronger seasonal demand has helped out – particularly a hotter than normal Chinese summer. Prices now are facing a seasonal slowdown, accentuated by government-enforced heavy industry closures. Competing hydro power supply is also at record seasonal levels, with heavy rainfalls in recent months. Overall, Chinese demand will remain pressured despite the recent stimulus, which looks service- rather than industry-targeted. Supply discipline continues, albeit marginally, with recent reports that Chinese producers are having some success in lowering costs. We expect seaborne prices to track sideways at about US$60/tonne.

Base metals have come under severe pressure as falling Chinese equity markets and mixed economic data have raised doubts about metals demand. However, we believe that selling has been overdone. Recent data suggest the fundamentals remain positive, with trade data showed strong growth in imports for various commodities. Investor positioning remains particularly short, and thus further falls cannot be ruled out. However, we remain of the view that prices will recover over the coming months as fundamentals take hold.

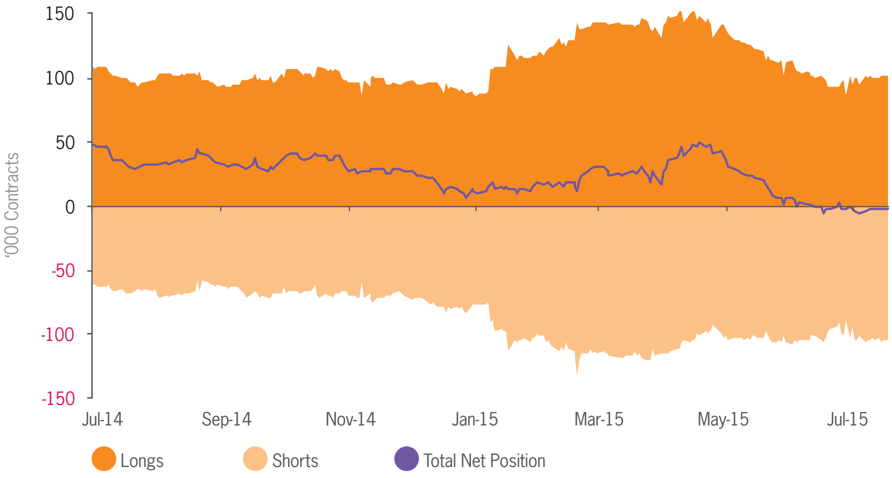
Figure 3: China Hydro Power Production



Source: Bloomberg, ANZ Research

Copper has taken the brunt of the selling in recent weeks. Supply disruptions that created some market tightness earlier this year have been overrun by weaker than expected demand in China. In particular, the deferral of funds allocations at the China State Grid has seen copper demand in the power sector weaken this year. However, prices are now inducing a supply response from producers, which should see some support emerge. Freeport recently announced that it was conducting a review of its mine plans and may cut production to preserve supplies for when market conditions improve. Ok Tedi suspended operations due to weak prices and the recent dry weather. It produces approximately 100 kilotonnes/year (ktpy) of copper.

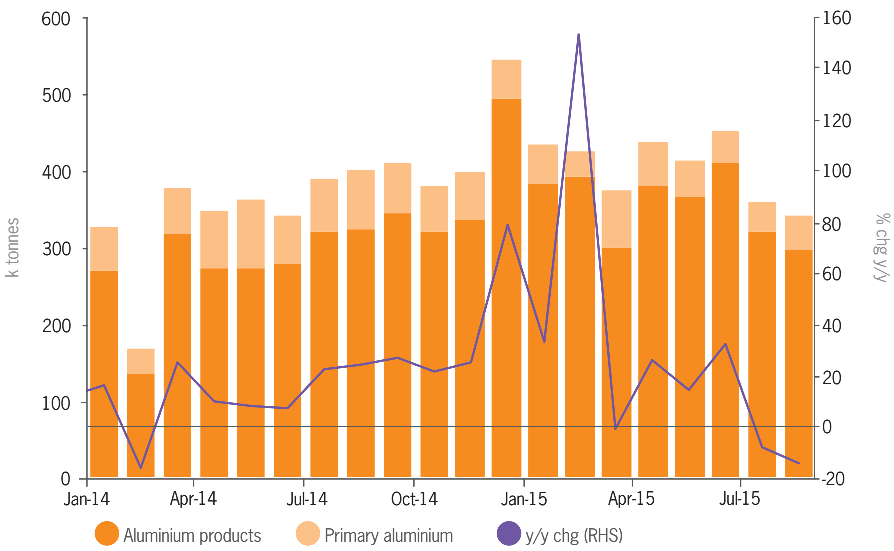
Figure 4: COPPER LME Non-commercial



Source: Bloomberg, ANZ Research

The continued outflow of ***aluminium*** from China is quickly pushing what was a relatively tight market into surplus. When combined with worrying signs of weak demand outside of China, prices are likely to remain under pressure in the coming months. Despite a collapse in the 'all in' aluminium prices (London Metal Exchange (LME) + regional premia), there has also been a lack of price-related supply cutbacks. This has been partly due to active producer hedging and forward selling earlier in the year, which will likely protect some portion of capacity for the time being. The fall in LME prices could be exposing the true fundamentals – that of a well over-supplied market. As such, prices may have to fall further in order to rebalance supply and demand.

Figure 5: China's aluminium exports



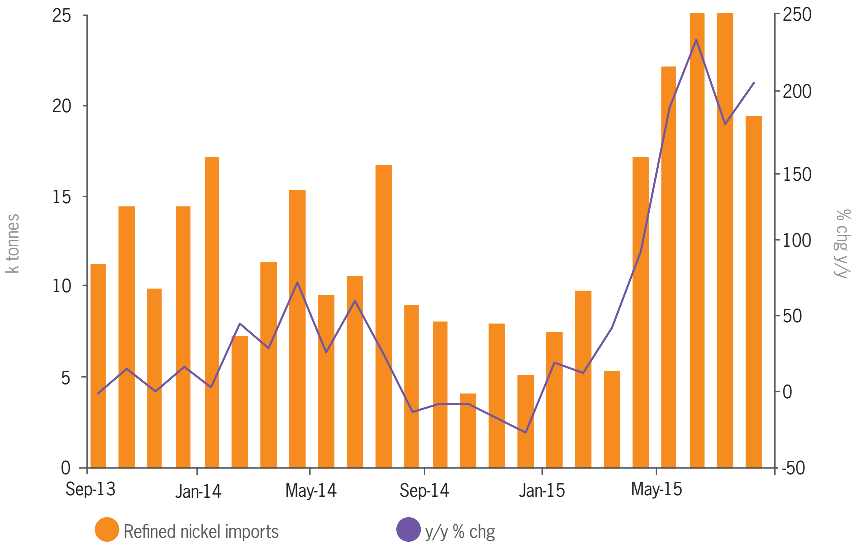
Source: NBS, Bloomberg, ANZ Research

Signs of an emerging tightness in the ***nickel*** market in China continue to strengthen. Chinese nickel imports surged again in June. Imports of refined metal were up 67% month on month and 250% year on year (y/y) to 38.8kt. Imports of ferronickel, a direct substitute for nickel pig iron, were also up strongly (255% y/y). At the same time, stocks of nickel ore at Chinese ports are at four year lows. However, prices have remained under pressure due to excessively higher inventories on the LME. While they have been steadily declining over the past two months, they remain close to the record high of 458kt reached in June. This is unlikely to remain the case if Chinese imports maintain their current trajectory, which should see support for nickel prices return over the coming months.

After breaking through a key support level of US$1,130/oz, *gold* traded to fresh five-year lows in recent weeks. Market sentiment in the metal still seems skewed to the downside, and it looks unlikely that the extent of negative investor positioning will reverse any time soon. We have revised down our forecasts for gold recently and expect prices to trough in December at US$1,020/oz. Silver will likely follow gold prices lower and test US$14.0/oz in December, while liquidation of investor long positions in platinum group metals has seen palladium and platinum forecasts revised lower.

Market positioning is reflecting a renewed negativity towards gold. The biggest shift recently has been the move in speculative positioning in Comex, where non-commercial traders are holding the largest gross short position in at least nine years (since the US Commodity Futures Trading Commission started recording disaggregated data). While an underlying theme driving the gold market lower has been the prospect of higher US interest rates and a stronger US dollar, the downside break through the key support level of US$1,130/oz has reset the market in a lower range.

Figure 6: China's imports of primary nickel

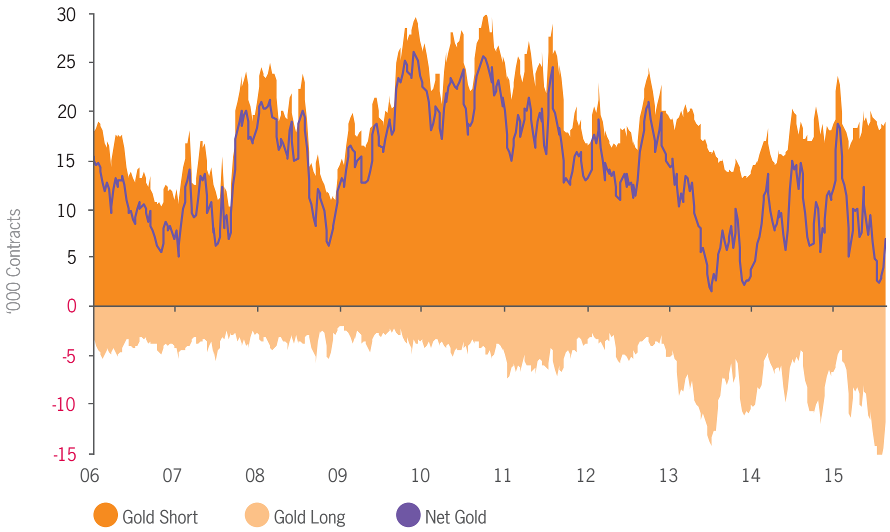


Source: LME, ANZ Research

"Legend has a positive outlook to exploration for nickel and copper in the Fraser Range, driven by investor perception about the ongoing demand for commodities from China coupled with the success of the Sirius story."

Mark Wilson
Managing Director
Legend Mining

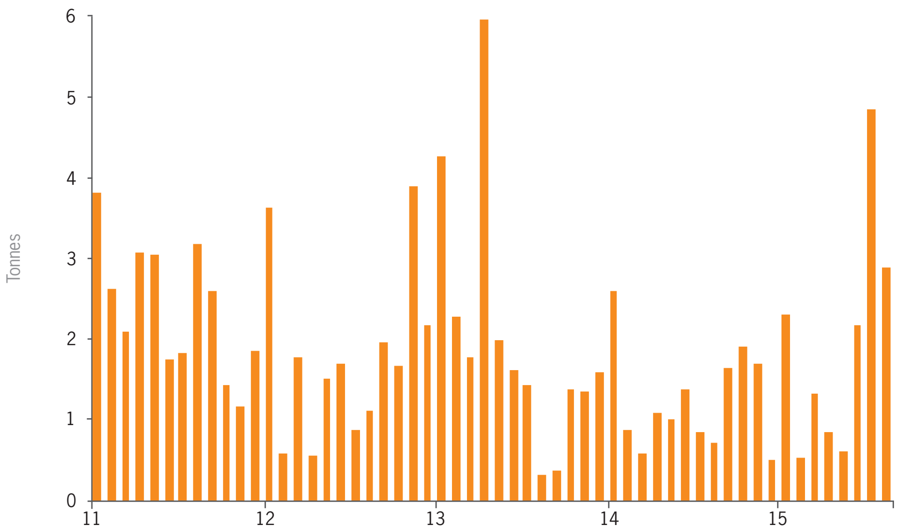
Figure 7: CFTC speculative position (Commodity Futures Trading Commission)



Source: Bloomberg, ANZ Research

Within this environment, demand for physical gold seems to have risen – and not just in China and India. Physical gold sales by the US Mint rose to 5.1 tonnes in July, the highest monthly sales total since April 2013. However, in the key consumer nations of China and India, soft onshore physical premiums suggest there is no shortage of supply either, despite signs of improved demand for physical gold. This is a key difference between market characteristics now and in 2013 when a scramble for physical gold in those key markets saw premiums reach record levels and supported the global gold price. We therefore do not expect that physical demand, despite being solid, will provide much of an offsetting lift to combat lower gold prices.

Figure 8: US Mint Bullion sales



Source: Bloomberg, ANZ Research

Investor positioning, particularly speculative positions on Comex, has turned quite negative in the past few weeks. Gross speculative short positions reached a record high of 202,000 contracts in the week to 21 July, while the gross long position is more in line with the average of the past 18 months. On a net basis, the net long position is at a record low of 17,000 contracts. Gold holdings of physically-backed exchange-traded funds declined sharply in July, falling by 53 tonnes in the month. Meanwhile, volatility has picked up sharply and the gold option markets suggest further downside risk as risk reversals have shifted sharply lower. We see little on the immediate horizon that will change the market's attitude towards the yellow metal.

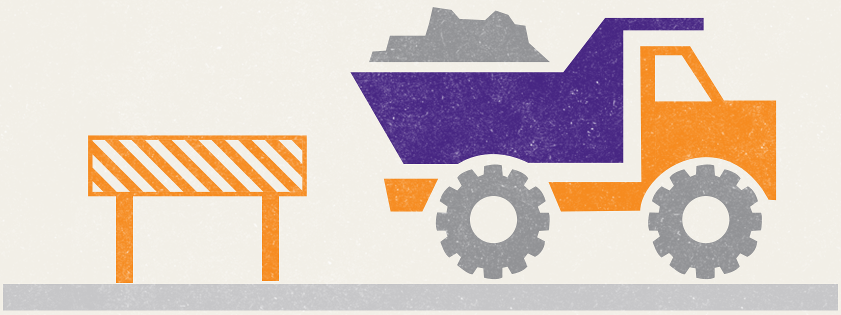
Constraints on growth

A majority of our respondents (62%) again cited lack of equity capital as the most significant constraint to their business growth. Looking back over past surveys, a lack of skilled staff was the main constraint for JUMEX companies in FY11. That constraint quickly dissipated as global market and commodity price instability hit, impacting investor appetite. The consequent scarcity of equity funding is now pervasive, with almost all respondents (92%) raising "lack of availability of financing" as the key issue for the industry as a whole for FY16.

As in 2014, the second key constraint to business in 2015 was the deterioration of company share price, reported by 48% of respondents. In the past two JUMEX surveys deterioration of company share price was predicted to be a much lower constraint to business than it actually became. Ongoing declines in share prices are extremely frustrating for JUMEX executives whose strategic options are significantly impacted by tumbling share prices.

The third most pressing constraint, cited by 43% of respondents, is volatility in commodity prices. Raising capital in volatile markets is extremely challenging and the continuing volatility in commodity prices over FY15 has further impacted efforts to raise capital and led to shareholder dissatisfaction.

For other companies, regulatory challenges, lack of debt funding and delays or challenges in negotiating arrangements for local government or community participation have been real constraints to business.



"Although there is over $100bn of resource sector-focused private equity sitting on the sidelines, only a small proportion is prepared to participate in traditional 5%–15% junior company placements. The majority of private equity is looking to make 100% project or corporate acquisitions, which are essentially a termination point for juniors …

… All mining deals need some risk capital to complete. A key barometer for the appetite for risk is the number of ASX mining IPOs in each calendar year. In 2011, mining IPOs were 70 (approximately 50% of total ASX IPOs). Since then they have steadily fallen, with 2015 being the worst year in living memory without a single mining IPO getting up since 1 January this year! "

Liam Twigger
Managing Director
PCF Capital

Top 5 key constraints to business

FY14 experience

1. Lack of availability of equity funding.
2. Deterioration of company share price.
3. Volatility of commodity prices.
4. Regulatory challenges (e.g. project approval delays).
5. General stability of financial markets.

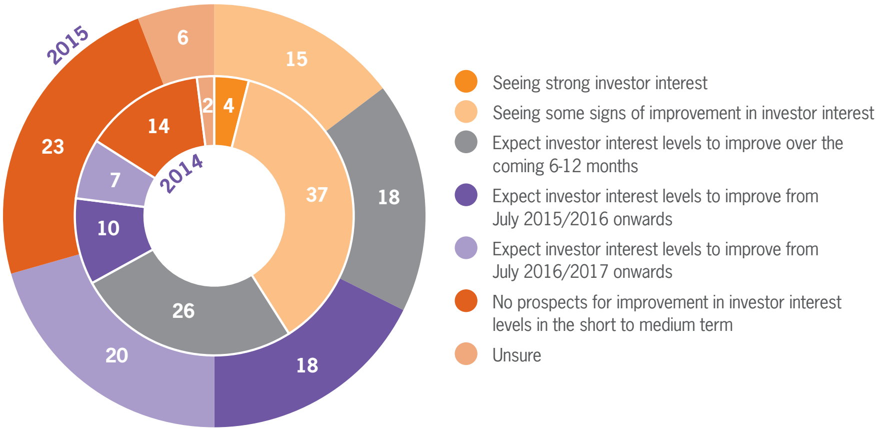
FY15 experience

1. Lack of availability of equity funding.
2. Deterioration of company share price.
3. Volatility of commodity prices.
4. General stability of financial markets.
5. Regulatory challenges (e.g. project approval delays).

FY16 prediction

1. Lack of availability of equity funding.
2. Volatility of commodity prices.
3. General stability of financial markets.
4. Deterioration of company share price.
5. Regulatory challenges (e.g. project approval delays).

Figure 9: Expectations for investor interest in JUMEX companies %



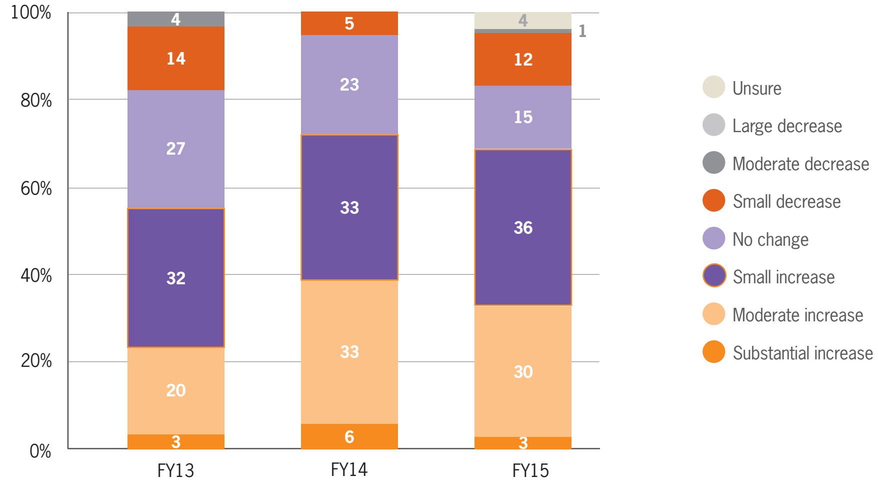
In the early months of FY15 there was a short period of improved optimism, which was shown clearly in the findings of our 2014 JUMEX survey. At the time of our 2014 survey (July and August 2014), 41% of respondents saw signs of improved investor interest, including a few who were seeing strong investor interest. Unfortunately the window was brief and closed in September 2014, when global markets experienced a few jitters and investors rapidly retreated, halting any contemplation of more speculative investments. Since then, investor interest in the JUMEX section of the market has remained very low. This year only 15% of respondents are seeing some signs of improved investor interest although the majority (56%) expect interest to improve from the later part of FY16 to FY18. Nearly a quarter (23%) see no prospects for improvements in investor interest levels in the short to medium term (up from 14% in FY14).

Respondent quote:

"Times are tough. There is money out there but there is intense competition for it."

"In our experience recently, any investor interest is very short term. Investors are still looking for reasons not to invest. Those that are investing are likely 'in the stock' already."

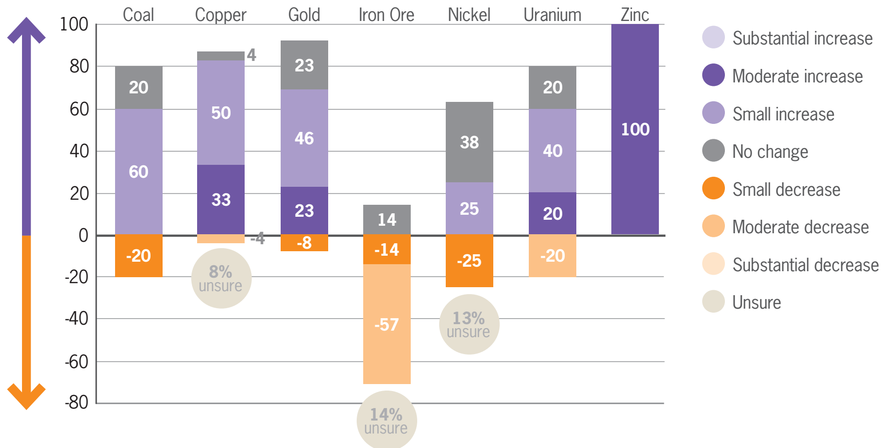
Figure 10: Expectations for pricing of key resource commodity - next 12 months



Overall, our respondents were cautiously optimistic of commodity price improvements, with 69% expecting an increase in the price of their key resource commodity over the next 12 months (a slight decrease from 72% in FY14).

However, looking at expectations by commodity is more revealing. Respondents with copper, gold or zinc projects are the most optimistic. For iron ore, the majority (57%) anticipate a moderate decrease in the iron ore price over the coming 12 months. A summary of expectations of respondents with projects focused on the main commodities is set out below:

Change expected in commodity pricing (%)



Respondent quote:

"We are not at the bottom of the commodity cycle yet."

Media report:

"Australian stocks plummeted today on the back of weak manufacturing data out of China, with the S&P/ASX 200 closing below 5000 points for the first time in more than two years."
www.miningnews.net
- 23 September 2015

Opportunities for innovation

Fundamental to the mining sector is the excitement generated by high quality discoveries, and for the best part of the decade to 2012 we saw ever-increasing money spent on new and existing deposits (albeit with a relatively short interruption to this trend at the peak of the global financial crisis). That spend was underpinned by a commodities pricing super cycle.

The strong commodities price growth also drove a focus on production over margin and, not surprisingly, more and more high cost projects came on line. However, with the commodity price cycle having turned sharply since then and the spotlight now on an industry with businesses operating at varying degrees of efficiency, producers have needed to adapt quickly to changed conditions and exploration interest has deteriorated sharply, matched by substantial falls since the peak in spending and meters drilled.

Respondent quotes:

"It's tough out there, so you have to look/think outside the box."

"It takes a very brave company to invest in innovation when cash is constrained even though there is no more important time to innovate."

"… Particularly encouraged by research into new and cheaper drilling technologies, and ongoing research into multi-element geochemistry continues to impress."

"If innovation means making a big discovery, then that's about the only thing that would make a difference. Any other innovation probably won't add any value, no matter how good it is."

It is disappointing that a third of respondents see innovation as having minimal or no impact on the sector in the coming 12 to 24 months. Many respondents commented that innovation and new technology is irrelevant if there is no money to pay for such things.

However, we firmly believe that innovation and technological development are crucial factors for the survival and success of the mining industry. The sector has been relatively slow historically to adapt to technological change; however, this is beginning to change. It is imperative that the industry innovates and it's typically these periods in the lower part of the cycle where necessity breeds innovation. Advancement in exploration techniques and drilling methods are examples of developments that are occurring currently, partly from necessity, and these will lead to better outcomes in the long term.

The challenge for the industry and juniors is to focus on high quality discoveries, which is particularly difficult given the funding constraints at the junior end of the market and the tightening of exploration spend within the majors. A cultural shift to portfolio management for juniors is something that is essential, with continuous movement in the project portfolios, rather than spending money on less prospective areas simply due to previous efforts and the need to justify prior spend.

On Opportunities/ Innovation

"From a Grant Thornton perspective we have seen a significant rationalisation of permit holdings and more and more partnerships via farm-out arrangements as companies with limited funding look at ways to advance their most prospective assets"

Brock Mackenzie
Partner - Audit & Assurance

"Innovation must be measurement led. There is nothing more motivating than seeing the impact of technology or process redesign on the performance of the operations however localised that may be. Without measurement we are never sure what we have achieved and therefore can lose the drive to do more."

David Singleton
CEO & MD, Poseidon Nickel Limited

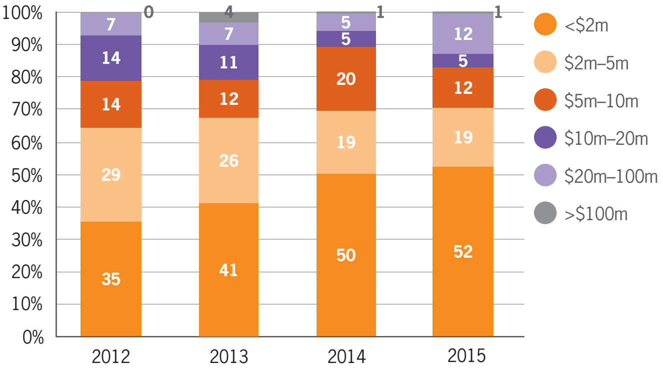
Funding: a persistent constraint

For the fourth consecutive year, the percentage of companies running low cash balances increased. At the time of our 2015 survey, 52% of companies had a cash balance under $2 million, up slightly from 50% in 2014, but a significant increase if you look back a few years. There was a 53% increase in the number of companies running a cash balance under $2 million in FY15 compared to FY12. When we started the JUMEX survey six years ago, $2 million was considered a level of cash balance at which companies could start thinking about the next fund raising, so we had that level as the lowest banding, yet now less than half of JUMEX companies have over $2m of cash.

In today's market, much lower levels of cash have become the norm. The percentage of companies with very low cash balances increased dramatically in 2015, with 29% of the companies surveyed having cash balances of less than $500,000 compared to 18% in 2014, while 9% had cash of less than $100,000. At such low cash levels, short-term survival becomes a priority, with little opportunity to focus on operational or strategic direction and insufficient funding to undertake corporate transactions.

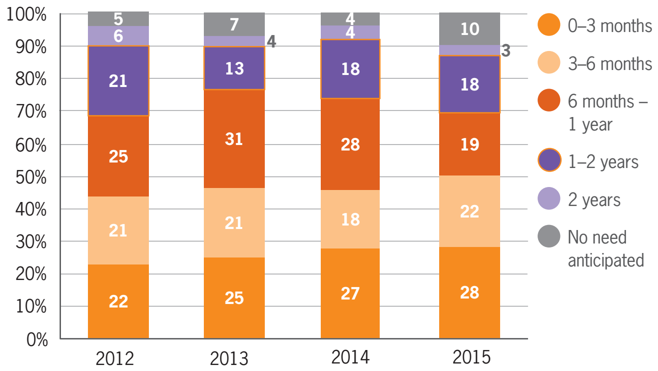
On a more positive note, 12% of respondents had cash balances over $20 million and these companies will clearly have a much wider range of strategic options available to them.

Figure 11: Current cash balance (%)



Running lower cash balances undoubtedly impacts a JUMEX company's ability to progress its projects, with 62% of JUMEX companies identifying a lack of equity funding as a key business constraint in FY15. While 50% of respondents are expecting to require a fundraising within six months (45% in 2014), for most companies the prospects of a successful raising at a level that would enable them to materially advance their projects seem negligible.

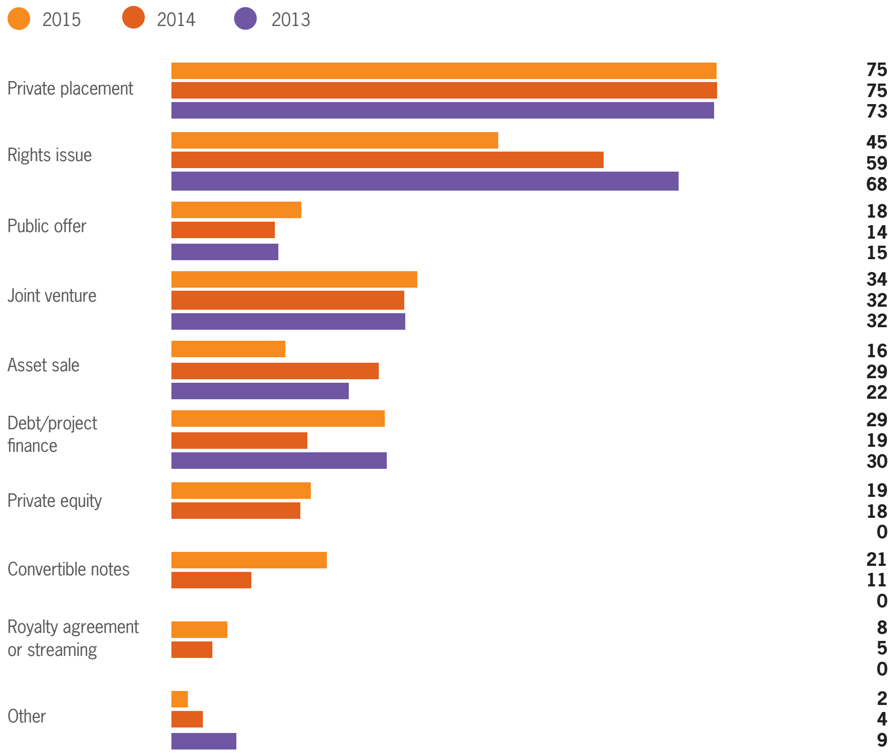
Figure 12: Anticipated timing of next required fund raising (%)

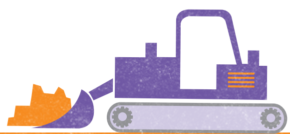


Funding: a persistent constraint

In terms of fundraising methods, private placements still remain the most popular, with 75% of companies planning such a fundraising in the next two years, a very consistent percentage compared to the previous two years. Interestingly, rights issues have recently become a lot less popular, under consideration by 45% of companies, a significant reduction on previous years. Historically, rights issues were a relatively quick and inexpensive way to top up working capital without diluting supportive shareholders; however, in recent times many companies have struggled to attract much interest, and have closed rights issues with very low levels of funds raised. There has also been a significant fall in the number of companies expecting to raise funds through an asset sale (16% in 2015 compared to 29% in 2014). Often a last resort option, convertible notes are now being considered by a higher percentage of companies (21% in 2015 compared to 11% in 2014).

Figure 13: Sources of funds considered for next raising (%)





Respondent quotes:

"Lack of working capital has caused significant delays in the implementation of exploration programs and influenced how the work programs have been carried out. To preserve funds, the company has reduced the working hours of all staff and sold assets."

"Threatening insolvency …"

"Working capital constraints have meant staff are unpaid or their incomes have been reduced."

Reflecting market conditions in Australia, 62% of respondents plan overseas investor presentations to expand the potential pool of investors, compared to 45% in 2014. Many JUMEX company directors have been supporting their companies financially for some time through reduced or even nil remuneration, or shares in lieu of cash. That support is expected to continue as 26% of companies are anticipating significant investment by directors as a proportion of the next fund raising, compared to only 12% in 2014. A consistent percentage of companies anticipate having to price their next equity raising at a significant discount (2015 38%; 2014 40%).

Despite numerous media articles about the billions of dollars earmarked by private equity investors for mining investments, there have been very few transactions completed. Nineteen percent of respondents are considering private equity for their next raising and there are a number of reputable private equity houses focused on the mining sector available to be approached by relevant companies. However, limited projects will appeal to the private equity sector, whose criteria for investment tend to be relatively narrow, with early stage exploration activities unlikely to be supported.

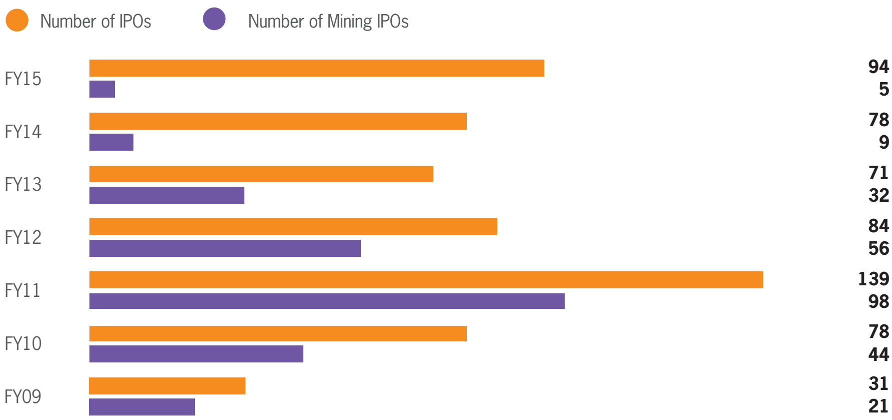
Respondent quote:

"Equity-raising for juniors is impossible."

"Even with good, tangible projects across a range of metals, retail funding is limited."

The IPO market remained strong in FY15, with another year of increases in the number of IPOs to 94 in FY15 (up from 78 in FY14). There were again some very significant IPOs, including Healthscope (raising $2.3 billion in July 2014) and Medibank Private (raising $5.7 billion in November 2014); consequently the total value raised on IPOs increased to $17.8 billion (up from $12.6 billion in FY14). There was also a significant increase in the average market capitalisation of companies on IPO in FY15 to $414 million, up from $355 million in FY13. However, this average is influenced significantly by South32, the spinout from BHP Billiton, which had a market capitalisation on IPO of nearly $11 billion. If South32 is excluded from the statistics, the average market capitalisation in IPO fell in FY15 to $290 million.

Figure 14: IPOs on ASX



Source: Australian Securities Exchange (ASX) and Grant Thornton analysis

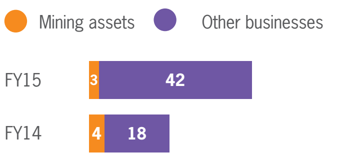
Despite the continued positive market conditions for IPOs in FY15, investor appetite for mining assets remained at very low levels. Hence, the number of mining IPOs fell again, to only five in FY15 (four in the first half of the financial year and the spinout of South32 from BHP Billiton in May 2015) and the average funds raised by mining companies on IPO fell to $2.8 million.

Figure 15: Mining IPOs on ASX

Source: Australian Securities Exchange (ASX) and Grant Thornton analysis

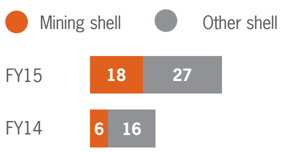
One major trend in FY15 was the increase in backdoor listings on the ASX, which more than doubled in FY15, from 22 in FY14 to 45 in FY15. There were very few mining assets/businesses that undertook a backdoor listing in either year. However, given the lack of available equity, particularly for early stage mining projects, many JUMEX companies have effectively become shells. There were 27 backdoor listings into mining shells in FY15, compared to only 6 in FY14.

Figure 16: Backdoor listings on ASX



Source: Australian Securities Exchange (ASX) and Grant Thornton analysis

Figure 17: Backdoor listings on ASX by type of shell company



Source: Australian Securities Exchange (ASX) and Grant Thornton analysis

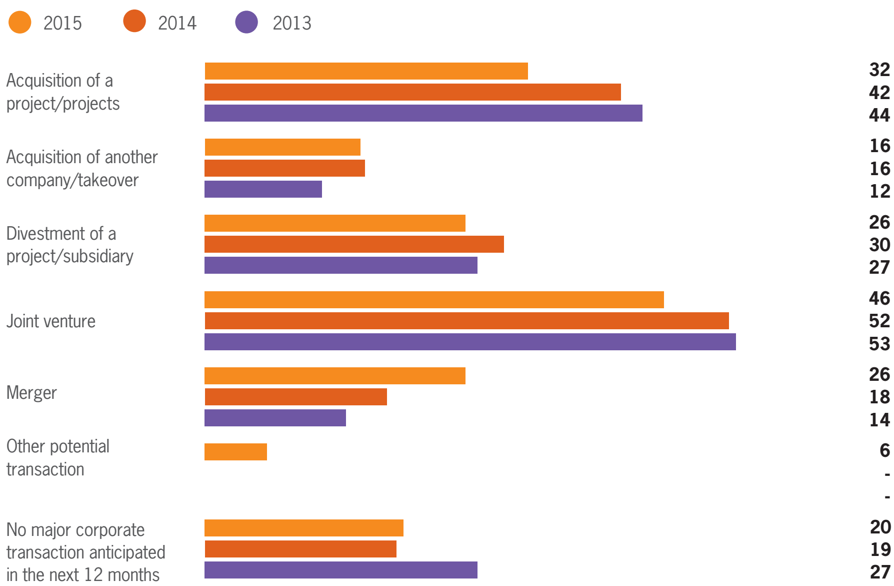
"The press would have us believe that the resources boom is over and that China is slowing down and in economic difficulties. While the Chinese GDP is reducing, and the huge infrastructure spending may have peaked, in my view it isn't so much that China is slowing down but more that there is a re-alignment of the economy, including a move to a more consumption-based economy. There is still a lot of urban development happening in inner city transport infrastructure, but there is now also an increasing emphasis on the use of its massive foreign capital reserves (which are greater than those of the next seven countries combined), to focus on overseas investments, including construction in regard to its Silk Road Strategy in Central Asia and in Africa."

Michael Atkins
Director, Corporate Finance
Patersons Securities

Realising strategic growth ambitions

Compared to many other industries JUMEX companies have always been very transactional, due to the nature of the business model. This continues to be the case, with only 20% of companies not considering a major corporate transaction in the next 12 months. Joint ventures remain the most common proposed transaction, under consideration by 46% of companies, while mergers have increased in popularity, with 26% of companies contemplating such a move in the next 12 months.

Figure 18: Any major corporate transactions considered to grow the business in the next 12 months? (%)



A major shift we have noticed in recent years has been a trend to refocus on Australia for future project acquisitions, following a period where many companies looked overseas, citing the high cost of doing business in Australia. Of those respondents considering acquisitions (either directly or via corporate acquisitions), 89% have Australia in their shortlist of jurisdictions to focus on, followed by 19% who are looking closely at Africa. The refocus on Australia seems to be driven by negative experiences in a wide range of countries overseas, as a result of political, social and other challenges. The cost of investigating and developing acquisition opportunities is also likely to be higher for opportunities overseas, increasing the attraction of local projects.

In terms of organic growth, 66% of companies have plans to expand their portfolio of assets through exploration in the coming 12 months, broadly consistent with 2014 (68%). However, the planned spend by many of these companies is relatively modest: 32% of such companies are planning to spend less than $500,000 and only 30% of companies are planning to spend more than $2 million (2014: 41%).

Respondent quotes:

"Mining companies with quality development or early stage mining projects continue to successfully raise funds, albeit at a discount to the upside potential. Greenfield explorers with grass roots projects continue to struggle as capital-raising becomes less successful and more frequent."

"You don't grow by standing still. Even with challenging markets you have to be active and maximise output while minimising costs."

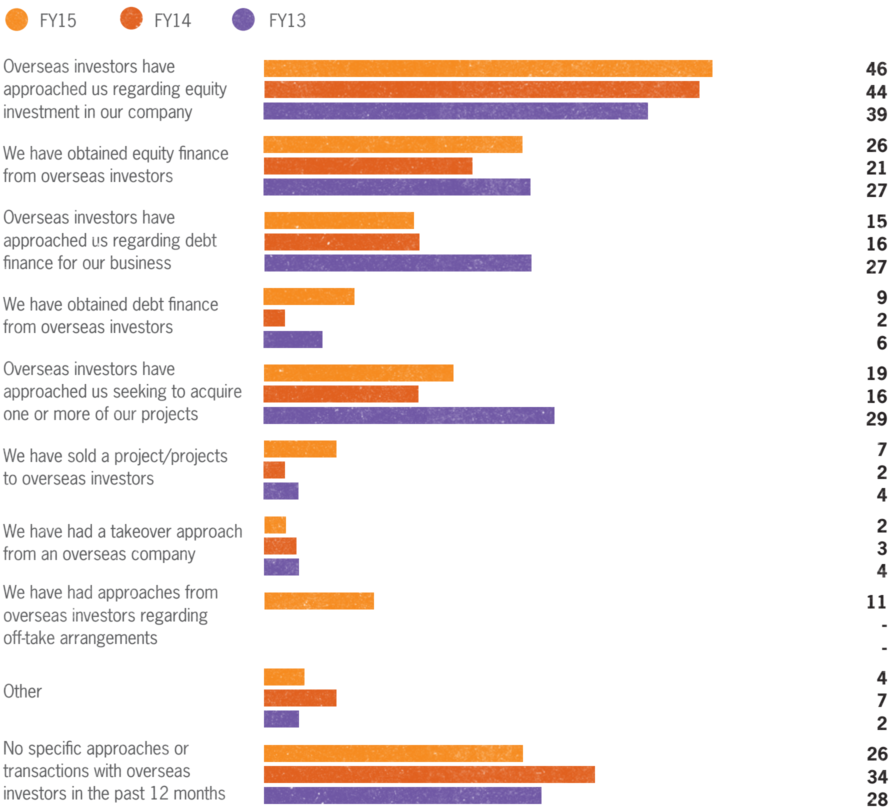
"Mergers between like small-cap resource stocks will continue, and is being demanded by shareholders to some extent as a means of reducing overheads."

However, despite cash constraints facing many JUMEX companies, 40% are planning a resource update in the coming 12 months, 35% are planning or already have underway a scoping study or PFS, with a further 20% planning or have underway a BFS. This suggests that many companies are, despite market conditions, managing to advance projects in a way that should add value to shareholders. Furthermore, 29% have a corporate strategy for FY16 that focuses on development of an asset into (full) production.

Despite these positive suggestions, 43% of companies have a key corporate strategy that is based on minimising expenditure until the company's funding position allows increased activity (2014: 44%). Only 23% include in their corporate strategy for FY16 the acquisition of attractive projects/ companies as a result of current valuations (2014: 28%) and this is consistent with a fall in the number of companies considering project acquisitions during FY16 to 32% (2014: 42%).

Reflecting the truly global nature of the industry, 74% of respondents had received an approach or conducted a transaction with overseas investors in FY15. Nearly half (46%) had been approached by overseas investors regarding equity investment (FY14: 44%) and over a quarter had obtained equity finance over the past 12 months from overseas investors. China continues to be the most frequent source of approaches/ transactions, with 46% of companies being approached or transacting with China (FY14: 48%). After China, other most common jurisdictions were North America (33%), other parts of Asia (33%) and Europe (25%).

Figure 19: What interest in your projects/company have you experienced from overseas investors in the past 12 months? (%)



Respondent quotes:

"This is a truly terrible environment – much worse than the GFC because juniors went into the GFC with cash. Now no-one has cash, and no ability to raise cash. Accordingly, everything must stop while we wait for better times, and hope we can survive that long ..."

Regulation and reform agenda

The most recent (June 2015) release from the Australian Bureau of Statistics regarding exploration figures sheds light on the significant role government needs to play from both a funding and access perspective.

Exploration figures in terms of total metres drilled are at the lowest level in the past 12 years and total exploration expenditure is the lowest since March 2006. The implications are significant as current exploration levels will determine the quality and extent of pipeline projects ready for development in the next cycle.

With the landscape and immediate economic outlook particularly challenging, it is imperative that public policy continues to seek initiatives designed to facilitate investment in exploration and the assets advancement.

The Exploration Development Incentive (EDI)* has been warmly received (provided for in the 2014/15 federal budget, with $100 million over three years), and provides an opportunity for participants to supplement other forms of capital. In further good news, the reversal of the controversial tax changes applied in 2009 to employee share schemes (ESS) passed through parliament and became effective 01 July 2015.

"While we commend the introduction of the EDI, it is imperative that the regulatory environment continues to adapt and assist the flow of capital within the mining sector"

Brock Mackenzie
Partner, Audit & Assurance

Figure 20: If regulatory challenges have been a constraint to business, what have the main issues been? (%)

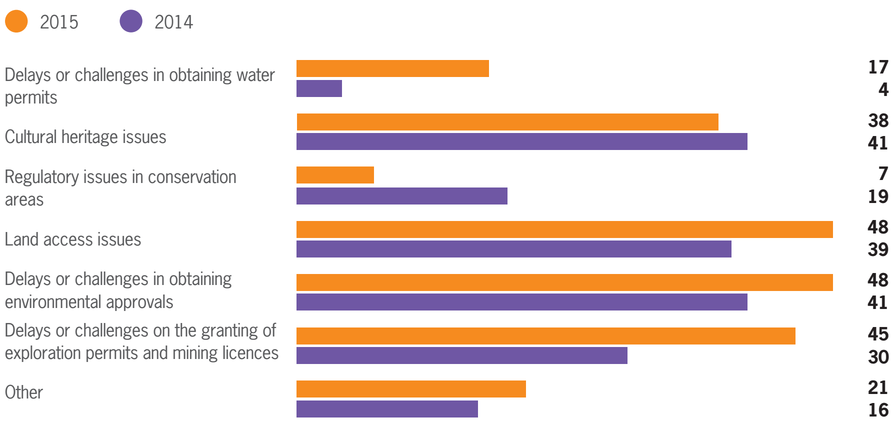
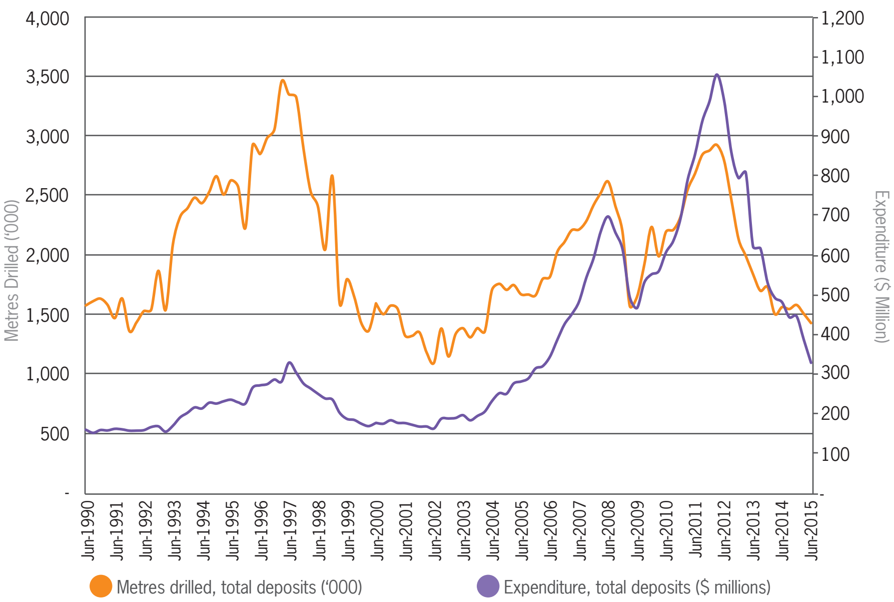


Figure 21: Mineral exploration, seasonally adjusted



8412.0 - Mineral and Petroleum Exploration, Australia, Jun 2015
"Mineral Exploration (other than for Petroleum)"

The regulatory environment has further changed recently, with certain fringe benefits arrangements receiving some relief, specifically fly-in and fly-out arrangements. Other proposals include opportunities to address stamp duty on exploration licenses across all states and territories, and, of course, the permit approval processes in each state and territory.

While these changes are undeniably positive, there is still much to be done. Governments (state and federal) can assist not only with funding, but also with approvals and permits. With 25 percent of respondents identifying regulatory constraints as a major impediment to business during FY15 it is clear that more needs to be done. The major issues for respondents identifying regulatory constraints impacting business growth regarded environmental approvals, land access, exploration permit approval and heritage issues. Addressing these constraints is particularly important during this phase of the investment cycle.

Increasing compliance risks – foreign bribery

Significant changes to Australia's foreign bribery laws are back on the political agenda. The Senate Economics References Committee is conducting an inquiry into foreign bribery, with its report due on 1 July 2016. A key issue that may arise is the potential removal of the statutory defence to the foreign bribery offence under the Criminal Code Act 1995, being that a payment was not a bribe but instead a facilitation payment.

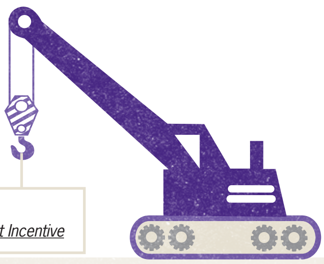
In summary, a facilitation payment is a nominal value (the term is not defined in the Code) paid to a foreign official for the sole or predominant purpose of expediting a minor routine action, documented as soon as possible. This defence is not available under the Bribery Act in the United Kingdom and is effectively treated as a bribe. A facilitation payment is not meant to influence a decision of a foreign official, only the timing. The defence creates the opportunity for payments that are in effect bribes to be rationalised as a facilitation payments and recorded as such in a company's books and records.

The potential removal of the statutory defence for facilitation payments is a call for action for junior minors to assess the risks of impending non-compliance and to put a plan in place to manage compliance. This will include the necessity to identify if facilitation payments are being made, the circumstances of such payments, how they have been accounted for and the impact of not been able to make them in future. Of particular risk is control over agents, distributors and contractors acting on behalf of JUMEX companies who may themselves be non-compliant which in some circumstances can create an offence of the JUMEX company itself. JUMEX companies operating in high risk countries such as many in Africa and Asia may see risks to their competitiveness which will need to be managed.

Insight provided by *Shane MacDonald* and *Courtney Gibson* both fraud and forensic specialists and Partners with Grant Thornton.

"With such tight capital markets it is key that JUMEX companies maximise the value of all expenditure. Regulators need to support the industry by minimising the cost and time commitments involved in obtaining necessary approvals and licenses."

Nicolas Smietana
Senior Manager, Audit & Assurance



*See our commentary regarding the EDI here:
The deadline is looming for the Exploration Development Incentive

Winning the talent battle

The ongoing transition for JUMEX companies from the investment phase to the production phase of the mining cycle, combined with softening commodity prices and a severe shortage of capital continues to put downward pressure on mining employment.

The cautious approach to employment which was reported last year remains, with 43% (2014:44%) of respondents indicating they were planning to maintain employee and contractor levels broadly at the same levels over the coming twelve months. Similarly, the number of respondents with declining and expansionary intentions also remained consistent with the prior survey.

With the Australian economy at the time of this report generating some surprisingly weak numbers (0.2% GDP for the June Quarter), and fresh concerns about China's contracting economy, a number of analysts are revising their forecasts for the Australian dollar and the economy more generally. Undoubtedly this continues to place pressure on the broader economy and the mining sector. The Australian Department of Employment in its most recent release last year forecast a decline in mining sector employment of some 4.2% for the five years to November 2018, representing a significant change from the 10 years to May 2014, which saw an annual growth rate of 10.3%. The forecast declines have and will impact Western Australia, Queensland and New South Wales more so than other states in terms of direct mining employment; however, the flow-on impact of the decline will be felt most by industries supporting the mining sector. These satellite industries include construction (development of mine sites and infrastructure), transport, postal and warehousing (materials handling and transport), manufacturing (downstream processing) and professional, scientific and technical services (engineering and technical support services).

Remuneration strategies remain consistent with the previous two surveys. The preferred non-cash form of remuneration is equity-based remuneration. Sixty-four per cent of companies (2014:65%) are supplementing base remuneration with share-based payments. The number of companies offering flexible working hours did increase significantly to 42% from 28%.

On winning the talent battle conditions:

"With non-cash remuneration likely to become ever less appealing given the returns on smaller cap stocks, and cash at a premium, a significant challenge for the sector is to retain talent and corporate knowledge"

Brock Mackenzie
Partner – Audit & Assurance

"The cost differential in relation to developing nations seems to have diminished due to increased labour costs and the weaker Australian dollar."

Dr Mike Jones
Managing Director
Impact Minerals

Respondent quote:

"The downturn has led to more realistic labour costs and scheduling. Looking at partnering with mining service companies on projects"

Survey methodology

Location of flagship asset

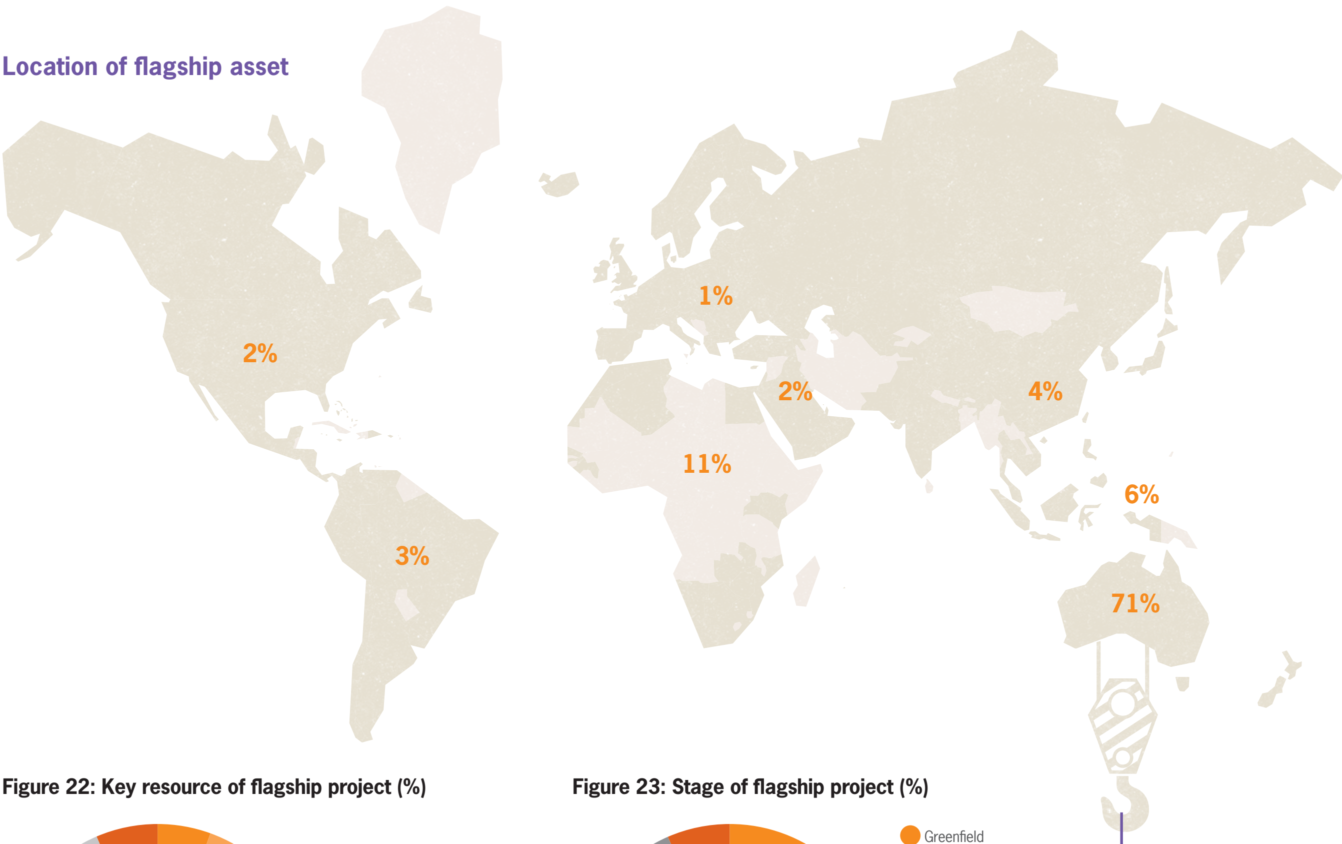


Figure 22: Key resource of flagship project (%)

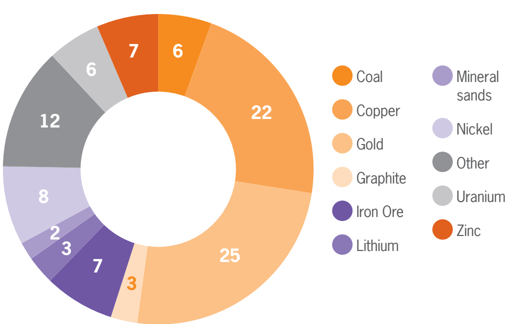
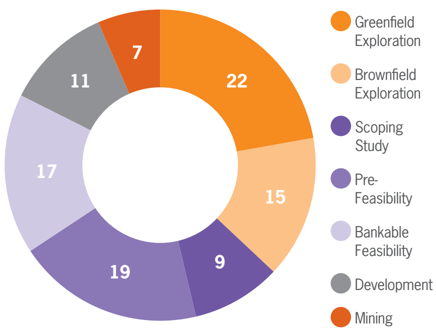


Figure 23: Stage of flagship project (%)

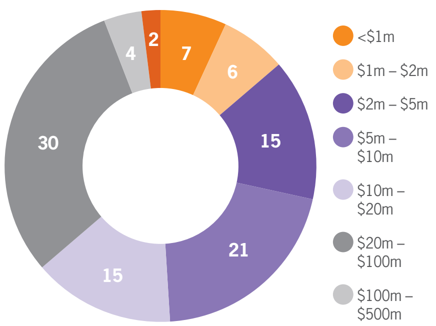


About the survey

This is the sixth survey of junior mining and exploration companies commissioned by Grant Thornton Australia.

The survey was conducted via a combination of online surveys and face-to-face interviews during July and August 2015, with 108 responses received. The majority of responses (67%) were received from Managing Directors, CFOs, CEOs and Executive Directors. The remainder were primarily non-executive directors, company secretaries and board chairman.

Figure 24: Current market capitalisation (%)



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Our sincere appreciation is extended to those that assisted us with this research and contributed to developing our deeper understanding of the market. We reached out to and were supported by a number of parties including:

ANZ provide a range of banking and financial products and services to around eight million customers and employ 48,000 people worldwide. Thank you in particular to Daniel Hynes who assisted with the macro-economic view and commodities outlook which is presented in the paper.

The Association of Mining and Exploration Companies (AMEC), which is the peak industry representative body for mineral exploration and mining companies throughout Australia. Our sincere thanks to Simon Bennison and his team for participating in our boardroom research discussions and helping us communicate the results.

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