

BREAKAWAY MINING WEEKLY

Recommendations/ Deals/ Listings/ Resource Updates/ Drilling Results; Drilling Underway/ Production/ Existing Projects/ Existing Projects in the Resources Sector

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WEEKLY OVERVIEW

Federal Government Steps In To Secure Domestic Gas Supplies

In recent weeks we have been following the unsuccessful discussions between the industry and Government on securing Eastern Australian gas supplies for domestic industry and retail consumption. It is not surprising that the companies cannot commit to providing domestic gas when they are contracted to supply international markets, part of the justification for the Gladstone LPG project funding in the first place.

The Federal Government has now stepped in with the Prime Minister stating that it will impose export restrictions on gas if it believes there is likely to be domestic shortages. There is no doubt that the real threat of Australia losing thousands of manufacturing jobs with unreliable supply and high gas prices. Resources Minister Matt Canavan stated this morning on the AM radio show that "It is not tenable for Australia to be the world's largest exporter of LNG [liquefied natural gas] but to have some of the highest prices for gas in the world."

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Federal Government Steps In To Secure Domestic Gas Supplies (Continued)...

So what does Breakaway Research believe are the implications for the resource sector and in particular, gas producers and explorers? In our view, we believe the following:

- Existing gas producers supplying LNG projects in Gladstone will be incentivised to source additional gas to meet domestic demand so that their LNG plants can operate continuously at full capacity to enjoy the economies of scale.
- Junior companies with undeveloped gas resources could be a target of these larger players and will also find it easier to raise capital.
- State Governments will come under increasing pressure to allow increased exploration for conventional and unconventional gas.
- Infrastructure projects such as gas pipelines (e.g. Galilee basin, NT – Mt Isa, etc.) will be constructed.
- It is likely to trigger "gas swaps" where companies will purchase extra gas offshore to replace redirected Australian gas from export to domestic demand.

The Government's best outcome is to ensure gas is available for Australian consumers at international prices so that the final shake out will be Eastern Australian gas supplies linked to international pricing and the oil price – an expectation that involved the rerating of early coal seam producers such as Queensland Gas and Arrow Energy when the concept of LNG production at Gladstone first emerged in the 2006.

Our selection for playing the Eastern Australian gas market has been Cooper Energy (ASX: COE). We have previously followed Richard Cottee's Central Pacific Petroleum (ASX: CPP) which could access the East Coast market via the proposed NT-Mt Isa pipeline but this is now the subject of a takeover by Macquarie. Blue Energy (ASX: BLU) with its extensive Queensland tenement position is also of interest but has taken a long time to react to the impending gas shortage.

CHANGING MARKET DYNAMICS

There are two major themes starting to play out in the investment space and which impact all investors. The first is the difficulties for active funds to outperform the market on a consistent basis. Indeed passive funds have outperformed most of the active funds during 2016 according to the AFR (26 April 2017) and this may also apply to active investment strategies formulated by financial planners. Earlier this month, the CEO of the world's largest fund, Bill McNabb of Vanguard, commented that the increased professionalism in the funds management industry had effectively made markets more efficient and ironically, harder to beat. This is supported by Financial Economist John Kay stating that the logic is compelling – as everyone is pursuing alpha with the same tools – it has to be the case that they can't do it.

Essentially the market is becoming more efficient as pricing anomalies are quickly rectified. Looking forward Kay believes that asset management will be much less about knowledge of markets and much more about underlying activities – whether it's the core strategy or business activity.

The second theme is relating to the fact that markets are 'shrinking' as many of the large tech companies that dominate the US and other markets do not require the capital that traditionally companies have. Essentially companies are less capital intensive than they used to be and typified by Apple and Google that have operating assets at just 5% of their total assets to show that in this modern age of capitalism, big companies don't need shareholder capital to finance them. The lack of capital intensity is best demonstrated by the fact that Amazon generated US\$136b of sales using US\$19b of invested capital while Walmart's sales of SU\$486b required US\$135b of capital.

Combined with the fact that even more capital is being returned to equity investors via buy backs and fewer companies are choosing to go public – and those that do are issuing shares to allow owners to cash out, not build businesses, is leading to shrinking markets. Kay cites that in modern advanced countries, equity markets are not the source of funding a business. In the UK and the US, equity finance is actually negative in that more capital disappears through acquisitions and share buybacks than is raised in new issues.

Credit Suisse analysis indicates that the number of companies that listed in the US rose 50% from 1976 to 1996 but has since fallen by 50% to 2016. In addition, its research indicates that listed companies are, on average, larger, older, and more profitable than 20 years ago and are more likely to pay out dividends and buy back shares, further shrinking the US market. Overall capital is being withdrawn and when there are IPOs, it is typically to provide a liquidity event for early stage investors, not to raise new capital for business.

Breakaway Research believe that themes developed in the articles and research highlight an increasing difficulty to earn alpha returns on portfolios and the structure of funds management industry means that there is reduced incentive for fund managers to invest outside the 'index moving' stocks. The market structure itself doesn't help as market direction becomes extremely important – if markets are moving higher, the smaller, higher risk stocks will outperform but if markets are moving lower, the larger 'index moving' stocks outperform. This applies equally to the resource sector and out portfolios/recommendations which are positioned for stronger market performance and suffer accordingly in weaker markets.

This also drives an investment strategy using ETFs – investing on market momentum driving particular sectors rather than investing to participate in the growth of a particular company.

WEEKLY COMMODITY PRICE MOVEMENTS

It has been a positive week for base metals except nickel. Nickel has fallen on concerns with Chinese demand after its trade data showed falling imports. Recent support has come from ore supply from the Philippines on environmental concerns but inventories still remain relatively high.

Gold and other precious metals fell with waning geopolitical concerns while iron has started recovering from recent lows. Oil is back below US\$50/bbl.

COMMODITY PRICES
COMMODITY PRICE AND INDEX MOVEMENTS OVER THE WEEK

Commodity Prices	Price/Level (today)	Price/Level at 19 th Apr 2017	Weekly Change	Market Movements	Price/Level (today)	Price/Level at 19 th Apr 2017	Weekly Change
Base Metal Prices (US\$/lb)				Broad Market Indices			
Copper	2.58	2.51	3.0%	DJIA	20,975.09	20,404.49	2.8%
Lead	0.99	0.98	1.6%	FTSE-100	7,288.72	7,114.36	2.5%
Zinc	1.19	1.15	3.4%	S&P/ASX 200	5,912.00	5,804.00	1.9%
Nickel	4.16	4.21	-1.1%	Mining and Energy Indices			
Aluminium	0.89	0.86	3.5%	S&P/ASX 200 Resources	3362.60	3352.80	0.3%
Tin	9.06	8.98	0.8%	S&P/ASX 300 Metals & Mining	2907.40	2904.50	0.1%
Cobalt	24.95	24.95	0.0%	S&P/ASX 200 Energy	9356.10	9309.10	0.5%
Molybdenum	6.76	6.76	0.0%	S&P/ASX All-Ordinaries Gold	4384.00	4697.60	-6.7%
Precious Metal Prices (US\$/oz)				Global Mining			
Gold	1262	1279	-1.3%	S&P/TSX Global Mining	66.34	66.08	0.4%
Silver	17.59	18.22	-3.5%	Commodity Indices			
Platinum	945	968	-2.4%	CRB Index	183.44	188.09	-2.5%
Bulks & Oil				LME Index	2780.70	2708.50	2.7%
Oil WTI (US\$/bbl)	49.40	51.60	-4.3%	S&P GSCI	2251.39	2327.19	-3.3%
Thermal coal (US\$/t)	83.90	82.05	2.3%	Baltic Dry	1154.00	1296.00	-11.0%
Iron ore (US\$/t)	70.44	68.65	2.6%	Overnight snapshot			
Exchange Rates				Sources include Bloomberg, Macquarie, TradingEconomics, S&P, Commsec, Xe.com, marketindex.com, Reuters, Breakaway Research yahoofinance.com			
AUD/USD	0.746	0.766	-2.6%				
EUR/USD	1.088	1.076	1.1%				
USD/ZAR	13.28	13.03	1.9%				

BREAKAWAY RESEARCH PORTFOLIOS – IDEAS FOR INVESTORS

Breakaway Research maintains two portfolios and a watch list outlined in the following tables. They are designed to provide ideas to investors where Breakaway Research considers there are opportunities to outperform the resource sector indices. However the portfolios are presented as 'general advice' and do not consider the financial or otherwise circumstances of the investor and of course, investment in the resource sector is often speculative in nature given the multiple variables which drive the share prices.

BREAKAWAY LOWER RISK PORTFOLIO

The *Lower Risk Portfolio* list stocks which Breakaway Research assess as generally large enough to have a number of producing operations, have market capitalisations that is generally in excess of \$500m and a more resilient balance sheet in comparison to companies in the other portfolios. Breakaway Research considers that the companies listed in the portfolio have the right exposure to the current momentum in the sector and/or are likely to surprise on the upside.

Company	ASX Code	Share Price (as at 27th April)	Initial Recommended Share Price (buy up to, \$)	Market Capitalisation (\$M)	Main Commodity Exposures	Rationale
Cooper Energy	COE	0.355	0.39	254	gas/oil	Attractive gas play in Eastern Australia, recent acquisition of Santos assets in Bass Street provides exposure to rising prices in the Eastern Australian Gas market
Fortescue Metals Group	FMG	5.24	6.78	20,364	Fe	Leveraged to iron ore prices, improving cost structure and cash flow reducing debt.
Independence Group	IGO	3.26	3.84	2,013	Au, Ni, Zn	Diversified WA portfolio with strong base metal exposure
Oz Minerals	OZL	7.02	10.00	2,497	Cu	Copper play (Prominent Hill, SA) with portfolio of growth projects
Resolute Mining	RSG	2.24	1.73	991	Au	Dominantly West African gold production, low debt, \$283m in cash and an aggressive exploration strategy
Sandfire	SFR	5.70	6.42	1,014	Cu	Copper play (DeGrussa, WA) with active management
South32	S32	2.81	2.95	15,705	Al, Mn, Zn, Pb, Ag, Met Coal	Diversified portfolio of assets in 'industrial' commodities, particularly leveraged to steel and aluminium demand

BREAKAWAY LOW RISK PORTFOLIO UPDATE

The performance of our *Low Risk Portfolio* has improved over the week with the recovery in base metal prices. We continue to have confidence in our stock selection which is positioned for an upswing in the markets as global economic growth becomes the major theme rather than the geopolitical tensions which are occurring today.

BREAKAWAY SPECULATIVE PORTFOLIO

The *Speculative Portfolio* comprise stocks which offer special situations where recent drilling results or other exploration activities, commodity exposure and/or momentum could generate significant above market returns. However, the companies/projects have a higher level of risk than the companies recommended in the *Lower Risk Portfolio* described above.

Company	ASX Code	Share Price (as at 27th April)	Initial Recommended Share Price (buy up to, \$)	Market Capitalisation (\$M)	Risk	Main commodity exposure	Rationale
Atlas Iron	AGO	0.015	0.047	320	High	Fe	High leverage to higher than expected Fe prices, strong cash flow and increasing resilience
Hillgrove Resources	HGO	0.075	0.063	18	Very high	Cu	Restructuring and a \$5m raising has alleviated short term cash problems. Better production performance and an outlook of improving copper prices could significantly derisk the company.
Hot Chili	HCH	0.033	0.042	20	High	Cu	Is developing its flagship Productora copper project on the coastal range in Region III, Chile.
Kidman Resources	KDR	0.35	0.505	132	High	Li	Advancing a world class lithium project in WA
Lepidico	LPD	0.014	0.014	26	High	Li	Lithium 'game-changer' technology
Panoramic Resources	PAN	0.28	0.39	144	High	Ni, Co	Selected Co play, diversified nickel operations
TNG Limited	TNG	0.15	0.165	129	Medium	Va, Ti, Fe	Mount Peake Vanadium-Titanium-Iron project represents a significant project. Todd River Resources demerger creates short term uncertainty
West African Resources	WAF	0.235	0.25	94	Medium	Au	Its Sanbrando Gold Project in Burkino Faso is being developed and moving towards 150koz pa production in 2019.

BREAKAWAY SPECULATIVE PORTFOLIO UPDATE

As mentioned earlier, most share prices have been impacted by the falling commodity prices and geopolitical uncertainty. Hence the underperformance relative to the major indices.

HYPOTHETICAL PERFORMANCE

Breakaway Research provides hypothetical performance estimation for investors to view the performance of our stock selections. The calculations assumed an equal investment of \$1000 at the time of the stock recommendation.

The Low Risk Portfolio has recovered with the generally increasing

Both portfolios have underperformed the broader market indices and reflects the diversification in the indices, particularly the domination of BHP and RIO which tend to outperform in a falling market. Nevertheless, we maintain our faith and expect to outperform in an upswing.

Hypothetical Portfolio Returns	20 th April 17	15 th Feb 17	Performance
Lower Risk Portfolio			-9%
Speculative Portfolio			-18%
Mining and Energy Index Performance			
S&P/ASX 200 Resources	3362.6	3595	-6%
S&P/ASX 300 Metals & Mining	2907.4	3204.8	-9%
S&P/ASX 200 Energy	9356.1	9220.8	1%
S&P/ASX All-Ordinaries Gold	4384.0	4707.8	-7%
Global Mining Index Performance			
S&P/TSX Global Mining	66.3	72.15	-8%
Commodity Indices Performance			
CRB Index	183.44	193.63	-5%
LME Index	2780.70	2904.20	-4%
S&P GSCI	2251.39	2405.30	-6%
Broad Market Indices Performance			
DJIA	20975.1	20611.86	2%
FTSE-100	7288.7	7302.41	0%
S&P/ASX 200	5912.0	5809.10	2%

BREAKAWAY WATCH LIST RECOMMENDATIONS

Stocks within the *Watchlist Portfolio* are in the process of potentially exciting exploration activities on prospects that offer significant upside if the results/activities yield positive results. These companies often have low cash reserves and low market capitalisations meaning that they offer significant leverage to any success but have attendant high risk.

Company	ASX Code	Share Price (as at 27th April)	Market Capitalisation (A\$m)	Risk	Main commodity exposure	Rationale
Artemis	ARV	0.09	29	High	Au	Drilling at the Carlow Castle Co Au Cu Project has produced encouraging results from the first 3 holes from an 8 hole program.
Trek Metals	TKM	0.041	9	High	Zn	Drilling on the Kroussou Project in Gabo will commence in Q1 2017 and follows up high grade grab samples. Low cash reserves.
Oro Verde	OVL	0.016	15	High	Au	Drilling is about to commence on the Nicaraguan Topacio Gold Project with Newcrest to fund the initial 1,650 metre program of seven diamond drill holes.
Toro Energy	TOE	0.036	96	Medium	U	Attractive uranium portfolio, awaiting Federal Government approvals, change of Gov't and uranium policy risk in WA
Investigator Resources	IVR	0.035	22	High	Cu	IVR has commenced drilling at the Nankivel copper-gold porphyry target.
Zinc of Ireland	ZMI	0.009	12	High	Zn	Option over the Galmoy processing plant, About to commence 3000m drilling programmed on Kildare project, Ireland

WATCHLIST PORTFOLIO UPDATE

Nothing material has occurred during the past week which has not already been reported in our Mining Daily.

BREAKAWAY RESEARCH

Breakaway Research Pty Ltd

Breakaway Research is an authorised representative of the Breakaway Investment Group Pty Ltd AFSL 290093. Breakaway has been researching mining and energy companies for more than 10 years and successfully combines technical and financial evaluation of resource companies to provide superior research.

Breakaway Mining Daily and the Breakaway Mining Weekly are part of a subscription based package available to investors. Stocks recommended are presented in our weekly portfolios (low risk and speculative) while we also provide a 'watch list' portfolio with companies that offer interesting opportunities but with significant risk.

Breakaway Research also provides commissioned research which is available to resource companies, is displayed on our website and distributed to the Breakaway Research database. Breakaway Research screens companies for suitability and merit prior to issuing a mandate to the company to produce an independent research report. Companies that mandate Breakaway Research may or may not appear in the portfolios offered to subscribers as these portfolios will take into account other factors such as commodity price trends, existing portfolio construction, sector momentum, etc. which may not form part of a mandated research report.

The team at Breakaway Research comprise experienced analysts with more than 25 years experience in geology and investment banking.

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Austex Mining Principal Rob Murdoch is an Australian geologist who has specialised in the management of junior resource companies for 30 years. His experience enables Rob to provide a quick and valid assessment on the potential of impact of many announcements, for example those involving new discoveries, drill results or resource upgrades and tracks the progress of companies on their various exploration or development projects.

Austex maintains an extensive database on all ASX listed resource companies, their corporate situations and the status of their various projects. This database helps to identify industry and investment trends which may not be apparent otherwise. Breakaway Research is extremely pleased to be able to utilise Rob's extensive experience in both corporate and technical capacity to assist in identifying resource investments that will directly benefit our subscribers.



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