

BREAKAWAY MINING MONTHLY

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

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JANUARY MONTHLY OVERVIEW

We have started the year with some strong movement in both precious and base metals and this has delivered an almost 10% return in global and Australian resource indices since mid-December apart from the gold and energy sectors.

The gold price has been volatile and fell this week to US\$1,338/oz following last week’s high of US\$1357/oz and follows yields on US benchmark Treasuries reaching the highest level since 2014, as the US dollar strengthens ahead of the Federal Reserve policy-setting meeting and US jobs data this week.

Outgoing Fed chair Janet Yellen has her final rate-setting meeting at the head of the US central bank before she is replaced by Donald Trump’s chosen successor, Jerome Powell. As noted by the Guardian, she commenced in February 2014 at a time when the money-printing machine of quantitative easing was whirring at full-tilt under her predecessor, Ben Bernanke. QE, which involved the Fed buying bonds from financial institutions, pumped billions of dollars into the US economy to keep it afloat after the financial crisis.

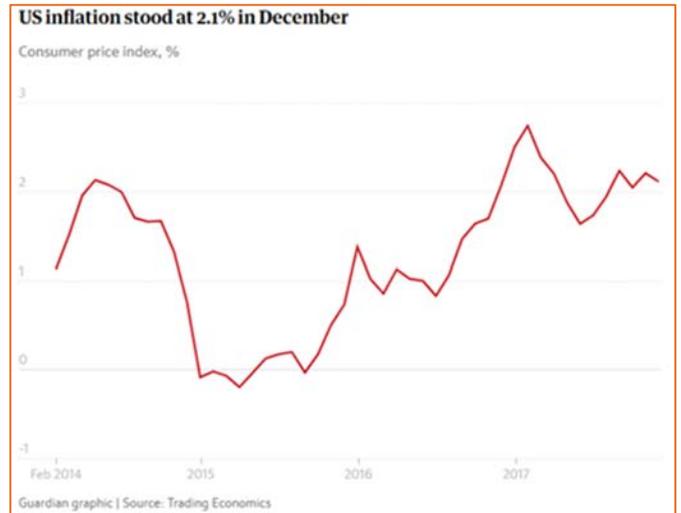
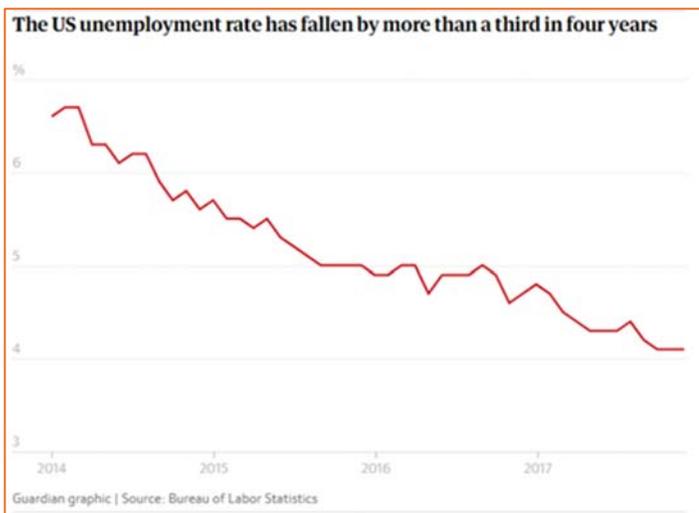
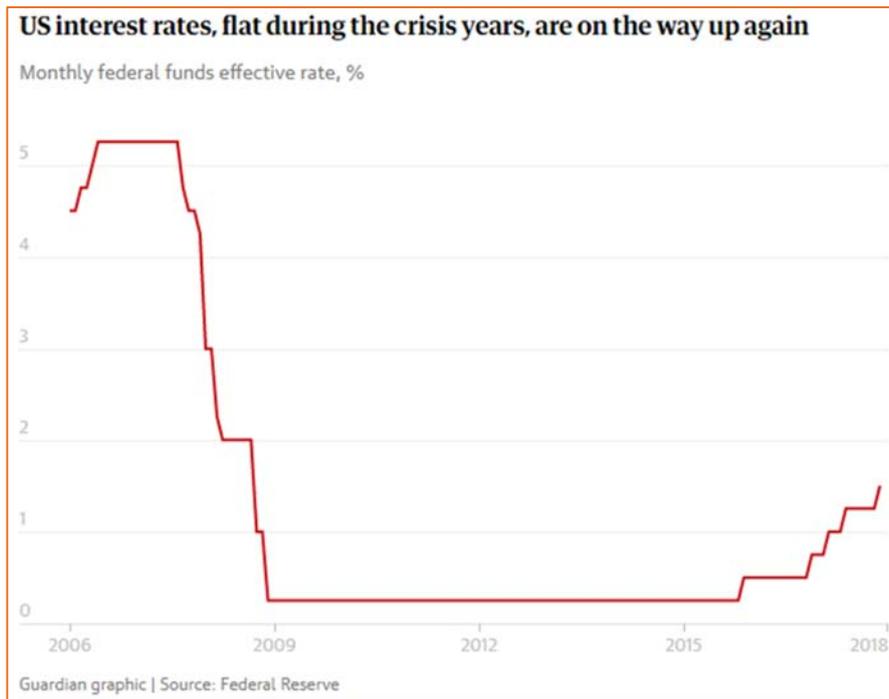
While no increase in rates is expected in February, further interest rate increases are expected later in 2018. US dollar strength and hence precious metal prices and less so, base metal prices will be dependent on market perceptions of on the ability to balance these interest rate hikes without upsetting the US economy – a test for incoming Jerome Powell.

SP Angel report that Bloomberg technical analysis highlights gold forming a Rounding Bottom pattern just as US bond yields are poised to end a down trend that’s held since the mid-1980s based on Ichimoku cloud analysis. If the January 2018 close for the 10-year yield exceeds 2.66%, this will be the first time in 35 years that the falling cloud pattern would have been taken out.

MONTHLY OVERVIEW CONTINUED...

With bond yields on the verge of an upside breakout amid rising inflation expectations, this could provide a tailwind for gold after a seven-year bear market, the broker reports.

Breakaway Research notes that there is no question that the market is expecting increasing US yields in line with increasing inflation expectations. Falling US unemployment and subdued but slightly increasing inflation are both positive.



The US stock market levels remain a concern and the new Fed Reserve Chair may preside over a time when a correction may occur which returns the Dow to more sustainable increases. A stimulus for this correction is not obvious and Breakaway Research believes it is likely to stem from the market not meeting earnings expectations rather than a significant over or underestimation of US inflation in the short term.

The US stock market has climbed more than 70% in four years

Dow Jones Industrial Average



Guardian graphic | Source: Thomson Reuters

While initially painful, a US market correction may lead to US dollar weakness and an increasing gold price (along with other commodities). However an alternative is that the US market may drift sideways at these lofty levels and use time to play a catch up game. Either way global fund managers are looking at alternative sectors for future investment returns including commodity demand and emerging markets. An example is the strong interest in electric vehicles and the expected associated commodity demand which may be more resilient than commodities influenced by Chinese construction or traditional export manufacturing

CHANGES TO BREAKAWAY MINING RESEARCH

As part of the ongoing evolution of Breakaway Research to meet client needs, we have made the following changes to our products:

- The Breakaway Mining Research Daily now includes a summary of highlights of the previous day's ASX announcements after our overnight market and commodity price update. This provides investors with a quick overview of the relevant highlights before discussing each announcement in more detail.
- During an interim period, we are shifting to a monthly report format with ad hoc updates published as necessary during the month.

Breakaway Research is moving towards revamping its website to provide investors with continually updated portfolios, news and investment themes as well as an interactive database of company announcement summaries and analysis. Overall this will include more timely and proactive recommendations on specific stocks and is a reflection of the success of the research to-date.

COMMODITY PRICE MOVEMENTS SINCE MID-DECEMBER

As noted earlier, commodity prices have generally moved higher over the last month with some strong performances in **zinc** (10.7%), **nickel** (16.2%), **tin** (14.3%) and **cobalt** (10.8%). While all commodity prices have been driven by US dollar weakness, the **zinc** price increase is well supported by low inventories and reduced mine supply. However while at first appearance the **nickel** price increase has been more speculative given current high inventories, there has been a market focus on future potential battery demand. Wood Mackenzie forecasts nickel usage in EV batteries at between 60,000-80,000 tonnes this year and 220,000 tonnes in 2025 reports CNBC. The threat to the nickel price is always the potential for higher production from Indonesia and the Philippines.

Tin is supported by strong demand and a shortfall in supply although Shanghai warehouse stocks remain relatively high and Indonesia continues to increase production. Stricter environmental regulations in China may reduce Chinese tin production leading to static supply and most traders expect a deficit in 2018. That said, in 2017 China surprised the market with the removal of a 10% export duty leading to increased Chinese exports including Yunnan Tin's 'processing trade' allowance.

The **cobalt** price increase continues to reflect expectations in future battery demand in electric vehicles. Indeed, BMO Capital Markets in December forecast annual average cobalt prices peaking at US \$40.50/lb in 2019 or moving even higher as reported by Platts. However interestingly in 2017 it aligned the 2017 cobalt rally to continued growth in smartphone sales as being the main end use market for cobalt. While technically true, Breakaway Research believes it is market speculation on future battery demand that are largely pushing the price higher. Elsewhere, BMO report that China announced a revised "E-bus subsidy policy" in late December. This prioritized higher battery quality technologies, essentially penalizing LFP (lithium iron phosphate) and benefiting NMC (nickel manganese cobalt) battery technology. It believes Chinese battery manufacturers have scrambled to add cobalt-containing NMC capacity and also raw materials to fill this given expectations that equivalent quality-driven subsidies will be put in place for car batteries.

Elsewhere **coking (metallurgical)** coals prices have increased on the back of mine and logistic disruptions. The disruptions includes problems at Teck's coking coal processing plant at the Elkview mine as well as operating problems at BHP Billiton's Queensland mines while some data indicates that a broad based Chinese restocking is required according to Platts. The risk is that as the logistics and operational problems reduce, so will the coking coal price.

Meanwhile the **iron ore** price increase has surprised on the upside. Chinese iron ore port inventories remain at around 148 million tonnes and are at the highest level since records began in 2012 according to Platts. Most analysts are forecasting the iron ore price soften during 2018 and make it difficult to invest in iron ore producers. This is mostly driven by iron ore supply growth, particularly in China and outside Australia and Brazil, which is expected to weigh on prices according to Reuters

COMMODITY PRICES

Commodity price movements during the past month are outlined over the next two pages:

| Commodity Prices | | Price/Level (today) | Price/Level at 15 th December 2017 | Change |
|------------------------------|-----------|---------------------|-----------------------------------------------|--------|
| Precious Metal Prices | | | | |
| Gold | (US\$/oz) | 1339 | 1255 | 6.7% |
| Gold ETFs | | 72.5 | 71.8 | 1.0% |
| Silver | (US\$/oz) | 17.10 | 15.71 | 8.8% |
| Platinum | (US\$/oz) | 995 | 885 | 12.4% |
| Palladium | (US\$/oz) | 1048 | 1028 | 1.9% |
| Base Metal Prices | | | | |
| Copper | (USc/lb) | 3.18 | 3.11 | 2.2% |
| Lead | (USc/lb) | 1.18 | 1.15 | 2.1% |
| Zinc | (USc/lb) | 1.61 | 1.45 | 10.7% |
| Nickel | (USc/lb) | 6.07 | 5.23 | 16.2% |
| Aluminium | (USc/lb) | 1.00 | 0.93 | 7.3% |
| Tin | (USc/lb) | 9.95 | 8.70 | 14.3% |
| Minor Metals | | | | |
| Cobalt | (USc/lb) | 36.29 | 32.75 | 10.8% |
| Lithium | (USc/lb) | 1.47 | 1.44 | 2.2% |
| Molybdenum | (USc/lb) | 7.14 | 7.09 | 0.7% |
| Tungsten (APT Europe) | (US\$/t) | 315 | 295 | 6.8% |

Energy

| | | | | |
|--------------|------------|-------|-------|--------|
| Oil WTI | (US\$/bbl) | 64.35 | 56.88 | 13.1% |
| Thermal coal | (US\$/t) | 86.30 | 90.00 | -4.1% |
| Uranium | (US\$/lb) | 21.40 | 24.40 | -12.3% |

Steel

| | | | | |
|--------------------|----------|--------|--------|-------|
| Metallurgical coal | (US\$/t) | 214.30 | 182.30 | 17.6% |
| Iron ore | (US\$/t) | 72.60 | 61.80 | 17.5% |

Market Movements
Mining and Energy Indices

| | | | | |
|-----------------------------|--|---------|---------|-------|
| S&P/ASX 200 Resources | | 4145.90 | 3671.80 | 12.9% |
| S&P/ASX 300 Metals & Mining | | 3657.20 | 3289.90 | 11.2% |
| S&P/ASX 200 Energy | | 8754.10 | 9222.40 | -5.1% |
| S&P/ASX All-Ordinaries Gold | | 4874.40 | 4895.50 | -0.4% |

Global Mining

| | | | | |
|-----------------------|--|-------|-------|------|
| S&P/TSX Global Mining | | 74.28 | 68.01 | 9.2% |
| FTSE 350 Mining | | 19159 | 17467 | 9.7% |
| AIM Basic Resources | | 2711 | 2605 | 4.1% |

Commodity Indices

| | | | | |
|------------|--|---------|---------|--------|
| CRB Index | | 202.57 | 183.39 | 10.5% |
| LME Index | | 3428.80 | 3238.70 | 5.9% |
| S&P GSCI | | 2683.63 | 2289.08 | 17.2% |
| Baltic Dry | | 1191.00 | 1332.00 | -10.6% |

Exchange Rates

| | | | | |
|---------|--|-------|-------|-------|
| AUD/USD | | 0.808 | 0.807 | 0.2% |
| EUR/USD | | 1.240 | 1.204 | 3.0% |
| USD/ZAR | | 11.98 | 12.93 | -7.4% |
| USD/CNY | | 6.32 | 6.48 | -2.4% |

Overnight snapshot

Sources include Bloomberg, Macquarie, TradingEconomics, S&P, Commsec, Xe.com, marketindex.com, Reuters, Breakaway Research yahoofinance.com

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 over the medium term. However the portfolios are presented as 'general advice' only 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 assesses 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 30 th January 2018) | Market Capitalisation (\$M) | Main Commodity Exposures | Rationale |
|------------------|----------|---------------------------------------------------------|--------------------------------|------------------------------------|-------------------------------------------------------------------------------------------------------------------|
| Senex Energy | SXY | 0.40 | 579 | gas/oil | Exposure to onshore oil and gas assets in the Cooper and Surat basins. Exposure to Eastern Australian gas crisis. |
| Evolution Mining | EVN | 2.77 | 4,672 | Au | Australian diversified gold producer which is pro-active |
| Oz Minerals | OZL | 9.40 | 2,769 | Cu | Copper play (Prominent Hill, SA) with portfolio of growth projects |
| Sandfire | SFR | 7.31 | 1,134 | Cu | Copper play (DeGrussa, WA) with active management |
| South32 | S32 | 3.83 | 20,568 | Al, Mn, Zn, Pb, Ag, Met Coal | Diversified portfolio of assets in 'industrial' commodities, particularly leveraged to steel and aluminium demand |
| Western Areas | WSA | 3.28 | 895 | Ni | Strong leverage to the nickel price |
| Whitehaven Coal | WHC | 4.93 | 4,966 | Coal | NSW dominantly thermal coal producer |

BREAKAWAY LOW RISK PORTFOLIO UPDATE

In this report we have sold FMG and purchased both Western Areas and Whitehaven Coal.

Deletions - Sell

FMG – FMG has retained a long-term position in our low risk portfolio since February 2017 when iron ore prices were substantially higher. As noted in our commodity review above, iron ore prices are forecast to be flat or lower in 2018 and hence we have also decided to divest this stock. Over the last 12 months our analysis suggests that Rio Tinto or to a lesser extent BHP Billiton, have provided better iron ore exposure with increasing iron ore prices and with less downside risk due to the commodity mix in these companies.

Additions

Whitehaven Coal (ASX Code WHC) Price: \$4.92

Company Overview

Whitehaven (WHC) is a NSW-based coal producer with operations and development projects in NSW Hunter Valley – Narrabri region. The Narrabri and Maules Creek mines dominate production with production ranging from high quality thermal coal, to semi-soft coking and PCI coals for export markets. The company has a growing production profile with its existing operations and is currently progressing the new Vickery project.

Recent Developments

Recent weaker than expected production has led to a reduction in FY18 production guidance (largely Narrabri production downgrade and higher cost expectations). Now factored into the market, coal prices remain firm and are underpinning strong cash generation and debt reduction. Dividends may also surprise on the upside.

Recommendation - Buy

We believe thermal coal prices will move higher as China's thermal coal futures hit record highs earlier this week after four top utilities warned of potential heating and electricity shortages and as the worst blizzards this winter continued to blast some central and southern provinces, reports Reuters. Meanwhile production and earnings downgrades are now in the market and with upside risk to earnings and dividends for the current half year.

Western Area (ASX Code WSA) Price \$3.28**Company Overview**

Western Areas (WSA) is a nickel producer and explorer that is listed on the ASX and TSX. The company operates the Forrestania operations in Western Australia, which consists of two nickel mines and a processing plant. Over the next ten years, production is forecast to average of 25ktpa nickel in concentrate. WSA has an extensive exploration tenement portfolio which provides scope for future growth. In addition, the Cosmic Boy Mill Recovery Enhancement Project (MREP) is focused on additional nickel recovery from a tailing stream in the plant. It commenced construction in the September 2017 quarter, at a cost \$17.5 million and is forecast to increase mill recoveries by 3% to 5% and contribute an additional 1,400 tpa nickel.

Recent Developments

WSA appears to be on track to meet annual production guidance and we would not expect risk to the downside.

Recommendation - Buy

WSA is a focused nickel producer with modest growth and strong leverage to the nickel price. In addition, a significant part of its recent price surge actually reflects a recovery from heavy price falls mid last year on the back of Indonesian and Philippine over-supply risks rather than the market focusing on the potential new demand from batteries.

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 30 th January 2018) | Market Capitalisation (\$M) | Risk | Main commodity exposure | Rationale |
|------------------------|----------|---------------------------------------------------------|-----------------------------------|--------|-------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Doray Minerals | DRM | 0.245 | 87 | Medium | Au | Low priced Australian gold producer with two WA operations: the Deflector Gold/Copper Mine and the Andy Well Gold Mine which will move to Care & Maintenance but provides significant optionality. |
| Hillgrove Resources | HGO | 0.099 | 56 | 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. |
| Highlands Pacific | HIG | 0.091 | 86 | Medium | Cu, Au, Ni | Exposure to world class copper, gold and nickel projects in PNG. |
| Kidman Resources | KDR | 1.97 | 690 | High | Li | Advancing a world class lithium project in WA |
| Lepidico | LPD | 0.057 | 164 | High | Li | Lithium 'game-changer' technology |
| Panoramic Resources | PAN | 0.50 | 215 | High | Ni, Co | Selected Co play, diversified nickel operations |
| Peel Mining | PEX | 0.82 | 151 | High | Au, Cu, Pb/Zn | Exploration in the Cobar region, NSW. Recent discoveries including Mallee Bull highlight the potential of the area |
| Pepinnini Minerals | PNN | 0.037 | 19 | High | Li | Strategic position covering lithium-brine projects in Argentina and Musgrave Ni exploration. |
| S2 Resources | S2R | 0.175 | 43 | High | Au, Cu, Ni, PGM | Aggressive explorer with proven track record. WA and Finland focus. |
| West African Resources | WAF | 0.425 | 246 | Medium | Au | Its Sanbrando Gold Project in Burkino Faso is being developed and moving towards 150koz pa production in 2019. |

BREAKAWAY SPECULATIVE PORTFOLIO UPDATE

The Speculative Portfolio has continued to perform well with particularly strong performances from Kidman Resources (+290%), Lepidico (+307%), Pepinnini (+106%), Peel Mining (+343%) and West African Resources (+70%). S2 Resources has provided the only negative returns (-3%).

We have refined our portfolio by selling Artemis Resources and purchasing Highlands Pacific

Deletions - Sell

Artemis Resources

Investors will recall that Artemis is part of the Pilbara Conglomerate Gold companies which delivered strong speculative returns in 2017. The companies speculated that an extensive gold bearing conglomerate in the Pilbara region was similar to South Africa's Witwatersrand Basin.

In addition, the large market value (+1 billion) of TSX listed Novo Resources (TSXV: NVO) meant that companies like Artemis were relative cheap given the relative tenement positions. Feedback from Canada on Novo's recent announcement has met with broad disappointment based on the lack of significant drill assays from a first-pass 69-hole drill program on the flagship Purdy's Reward asset. Indeed, the moderate and varied assays from bulk sample concentrates failed to reassure the market on the proof-of-concept program, reports Canadian brokers.

In our view Artemis represented the best exposure if the conglomerate gold concept could be proved to be correct but this is now becoming doubtful. Hence Breakaway Research's decision to exit the stock.

Additions – Buy

Highlands Pacific (ASX Code HIG) Price \$0.091

Company Overview

Highlands Pacific (HIG) has a 20-year operating history in PNG. It currently has 8.56% interest in the Ramu nickel-cobalt mine which is in production, the Freida River copper-gold project which is currently being permitted, the Star Mountain copper-gold advanced exploration project and the early stage Sewa Bay nickel laterite project.

Recent Developments

HIG have been keen to point out that Ramu produces almost 10% of the world's non-DRC cobalt production.

Recommendation - Buy

HIG has exposure to battery metals, copper, nickel and cobalt and should benefit from any price movements in these metals. In addition, permitting and commitment by the Chinese to develop Freida River would be positive. Elsewhere Star Mountain is a difficult project and Sewa nickel laterite intersections to-date are a bit skinny, but these projects are likely to be overshadowed by the other factors – particularly potential metal price increases.

HYPOTHETICAL PERFORMANCE

Breakaway Research provides hypothetical performance estimation for investors to view the performance of our stock selections. The calculations assume an equal investment of \$1000 for each stock at the time of the stock recommendation. At this stage, we do not adjust for the time for the holding period as the portfolio has operated for less than 12 months.

The **Lower Risk Portfolio** has underperformed the broader market indices which include BHP and RIO. This reflects some legacy positions like Fortescue which have fallen substantially from the February 2017 highs when the iron ore price was above US\$90/t and which has never recovered to this level since that time. As noted earlier, we are cutting out losses on FMG as both BHP and RIO perform better when the iron ore price moves higher or lower!

In contrast the **Speculative Portfolio** continues to outperform the indices on a relative basis as evident in the following table. Its 77% return reflects stocks leveraged to copper, gold, lithium and zinc and we continue to apply a greater emphasis on project quality.

| Hypothetical Portfolio Returns | 30 th January 18 | 15 th Feb 17 | Performance |
|--------------------------------------------|-----------------------------|-------------------------|-------------|
| Lower Risk Portfolio | | | -2% |
| Speculative Portfolio | | | 77% |
| Mining and Energy Index Performance | | | |
| S&P/ASX 200 Resources | 4145.9 | 3595.0 | 15% |
| S&P/ASX 300 Metals & Mining | 3657.2 | 3204.8 | 14% |
| S&P/ASX 200 Energy | 8754.1 | 9220.8 | -5% |
| S&P/ASX All-Ordinaries Gold | 4874.4 | 4707.8 | 4% |
| Global Mining Index Performance | | | |
| S&P/TSX Global Mining | 74.28 | 72.15 | 3% |
| FTSE 350 Mining | 19159 | 17138 | 12% |
| AIM Basic Resources | 2711.2 | 2740.0 | -1% |
| Commodity Indices Performance | | | |
| CRB Index | 202.57 | 193.63 | 5% |
| LME Index | 3428.80 | 2904.20 | 18% |
| S&P GSCI | 2683.63 | 2405.30 | 12% |
| Broad Market Indices Performance | | | |
| DJIA | 26091.6 | 20611.86 | 27% |
| FTSE-100 | 7588.0 | 7302.41 | 4% |
| S&P/ASX 200 | 6022.8 | 5809.10 | 4% |
| Global Majors | | | |
| BHP | 30.22 | 26.54 | 14% |
| RIO | 78.56 | 68.40 | 15% |

RESOURCE INDUSTRY ACTIVITY DURING 2017

The number of Resource Industry Announcements and Investor Presentations that were reviewed, and analysed during 2017 show a strong correlation with commodity price movements and broader interest in the sector.

During the year,

- Average monthly announcements relating to IPO's, new listing and relisting increased by 400%
- Average monthly announcements relating to new or updated resources/reserves have increased 57%.
- Project Evaluation including metallurgical testing, Scoping or Feasibility Studies and optimization, Pilot Studies, Well Appraisal, Testing of Downstream Applications and Permitting news has increased by 100%
- New drill or well intersections as confirmed by assaying or well logging is up around 38%
- New financings (+\$1M) have increased by 100%.
- Investor Presentations announced on the market have increased by around 50% over the year.

Overall the trend reaffirms that resource company executives need to be flexible in responding to improving market conditions with rapid promotion of their companies through announcements, presentations and research. The importance of having this flexibility is a sign that a company has the potential to fully capture the market upturns and this ability should be identified by investors as part of identifying their future investments.

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 assessment of companies, leading to superior research.

Breakaway Research offers products to meet the particular requirements of its clients:

- **Subscription Research** for investors with our Daily and Weekly reports summarising ASX releases, commodity price movements, overnight market news, investment themes, recommendations and portfolios.
- **Company Commissioned Research** which promotes the inherent value in companies and their projects to a broad range of investors utilising Breakaway's extensive distribution network including publishing in The Digger Newsletter.
- **Institutional Research** providing bespoke research relating to sectors, investment themes, strategies or particular companies for Institutional and Corporate clients.

Breakaway Research screens companies for suitability and merit prior to issuing a mandate for a Company Commissioned Research Report – hence there is a bias in our recommendations.

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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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