

# GALENA MINING (G1A)

**Lifting Price Target 75% to 70c on Toho deal & reserve/resource upgrade**

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We say

Price

Target

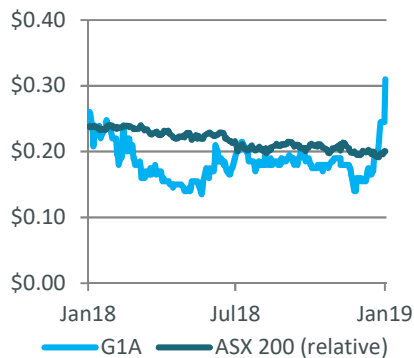
Strategic Target

# BUY

# 0.31 0.70 1.00

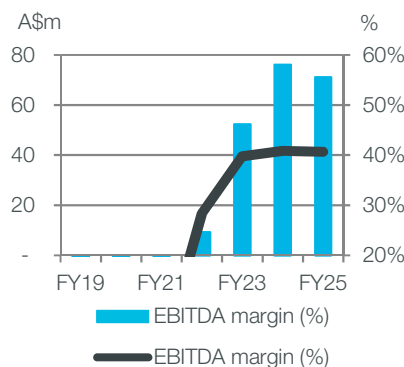
On the back of Galena's transformation deal with Toho Zinc (see below) and the company's major reserve/resource upgrade in December (which adds ~25% to our NPV), we increase our price target a very material 75% from 40c to 70c. The deal with Toho remains subject to normal conditions precedent, including confirmatory due diligence, however we believe it is highly likely to proceed, given the material benefit to both companies. On our forecasts, G1A is trading on only ~0.4x P/NAV.

## SHARE PRICE CHART



Source: IRESS, Blue Ocean Equities

## FORECAST EBITDA (A\$M) & MARGIN (%)



Source: Company, Blue Ocean estimates

## COMPANY DATA & RATIOS

Enterprise value	\$59m
Diluted market cap*	\$120m
Diluted shares*	388m
Free float	65%
12 month price range	\$0.12-0.36
GICS sector	Materials
Board & Management hold ~35%. *Diluted for 51.3m options & performance rights.	

## IMPLIED RETURN

Implied all-in return	126%
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## A TRANSFORMATIONAL DEAL WITH TOHO ZINC

Galena has executed a term sheet to sell 40% of its Abra lead project in WA to Toho Zinc for A\$90m. On our forecasts, this transaction should see Galena fully funded to build Abra by year end, once debt facilities are in place. Toho has also agreed to help Galena secure debt from Japanese export credit agencies, which is typically less expensive than traditional project debt. The Toho deal is expected to close in April.

## RESERVE/RESOURCE UPGRADE +25% TO NPV

On 17 Dec 2018, Galena released a revised reserve/resource upgrade lifting the planned Mining Inventory tonnes and grade by 7% and 6% respectively, which increases our NPV<sub>10</sub> for Abra by a material 25% to A\$437m on PFS assumptions, excluding the potential opex saving of ~13km less of lateral development. An optimised PFS is due shortly followed by a BFS mid CY19.

## IMPLIED RETURN OF OVER 120%

Factoring in both the Toho deal and the reserve/resource upgrade in Dec, we lift our Price Target a material 75% from 40c to 70c. A large proportion of this upgrade is due to the reduction in our discount to NPV from 50% to 10% to reflect both (A) the material reduction in risk associated with financing Abra and (B) the *material* reduction in potential dilution this transaction represents for Galena shareholders.

## TOHO BUYS 40% STAKE IN ABRA FOR A\$90M

After market close on 30 January 2018, Galena confirmed it has executed a term sheet to sell 40% of its flagship Abra lead project in WA to Toho Zinc for A\$90m, an excellent deal for Galena shareholders in our view. The market liked the deal too - when the stock resumed trading on 31 January, it rallied ~27% to 31c.

Factoring the A\$90m from Toho into our forecasts, once the newly formed 60/40 JV secures the necessary debt, [Abra should be fully funded to begin construction in Q4 CY19](#):

Funding Uses	A\$m	Funding Sources	A\$m
Initial capex	154	Debt ~53%	100
Working capital + exploration + other	36	Equity ~47%	90
<b>Total</b>	<b>190</b>	<b>Total</b>	<b>190</b>

Source: Company, Blue Ocean estimates

On our forecasts, at a US95c/lb lead price (vs. spot of US94c/lb):

- Abra has a post-tax NPV<sub>10</sub> of A\$474m
- Galena's 60% share of NPV<sub>10</sub> is A\$284m
- Galena's FD mcap at 31c is ~A\$120m based on FD shares of 388m (337m shares, 51m options & performance rights)

[i.e. In our view, despite the strong 27% rally yesterday, Galena is trading on 0.4x NPV and is still very good buying at 31c!](#)

The deal with Toho is subject to normal conditions, including confirmatory due diligence and FIRB approval and is expected to close in April 2019. The payment schedule is:

- A\$20m on transaction close (expected in April)
- A\$10m on completion of the DFS for Abra (expected in mid CY19)
- A\$60m once project finance is in place and all conditions precedent to drawdown are met (expected in Q4 CY19)

Toho will also:

- Assist project finance discussions via Japanese export credit agencies (typically more attractive interest rates and loan tenure)
- Be granted 2 of the 5 boards seats in the Joint Venture

An Optimised PFS for Abra is due shortly... and based on the strong reserve/resource update in Dec, we're expecting a material improvement in project economics compared to the PFS.

## “EFFECTIVE” CASH OF ~A\$61M

Assuming the transaction with Toho proceeds, in our estimation, Galena now has ~A\$61m in “effective” cash, being:

- A\$3.3m at end Dec 2018 +
- A\$10m from Toho which will be paid to the Galena parent company +
- A\$48m being Galena's 60% share of the \$80m Toho will pay into the JV company

## RESERVE/RESOURCE UPGRADE LIFTS NPV 25%

On 17 December 2018, Galena released a material reserve/resource upgrade for its Abra lead project in WA after incorporating the latest round of infill and extensional drilling.

Key highlights include:

- 9% increase in lead reserve grade to 8.8%
- 20% increase in silver reserve grade to 24g/t
- 7% increase in Mining Inventory to 16.4mt, increasing mine life 1 year to ~15 years

Our estimate of potential impact on project economics:

- 6% increase in lead production to 97ktpa  
(in line with 6% increase in Mining Inventory grade, see table below)
- 4% reduction in unit costs, excluding potential cost savings (see below)
- 6% increase in operating margins to 45%
- 25% increase in NPV<sub>10</sub> at US95c/lb to A\$437m
- 12% increase in IRR to 48%

We have provided more detail in the comparison table below but [these figures exclude the potential opex saving of ~13km less of lateral development](#) which was also flagged on 17 Dec 2018. Net net, we expect to see a material improvement in project economics in the optimised PFS which is due to be released in early 2019.

### Abra Reserve/Resource Upgrade in Dec 2018

Resource		PFS	New	Chg
Tonnes	mt	36.7	37.4	2%
Lead Grade	%	7.3%	7.5%	3%
Silver Grade	g/t	18	18	0%

Reserve		PFS	New	Chg
Tonnes	mt	10.5	10.3	-2%
Lead Grade	%	8.1%	8.8%	9%
Silver Grade	g/t	20	24	20%

Mining Inventory		PFS	New	Chg
Tonnes	mt	15.3	16.4	7%
Lead Grade	%	7.7%	8.2%	6%
Silver Grade	g/t	20	22	10%

Project Metrics @ US95c/lb lead		PFS	New	Chg
PFS Lead Price	US\$/lb	0.95	0.95	-
Lead-in-conc production	ktpa	91	97	6%
Avg Opex incl royalties	US\$/lb	0.54	0.52	-4%
Operating margins	%	43%	45%	6%
NPV <sub>10</sub> post-tax	A\$m	349	437	25%
IRR post-tax	%	43%	48%	12%

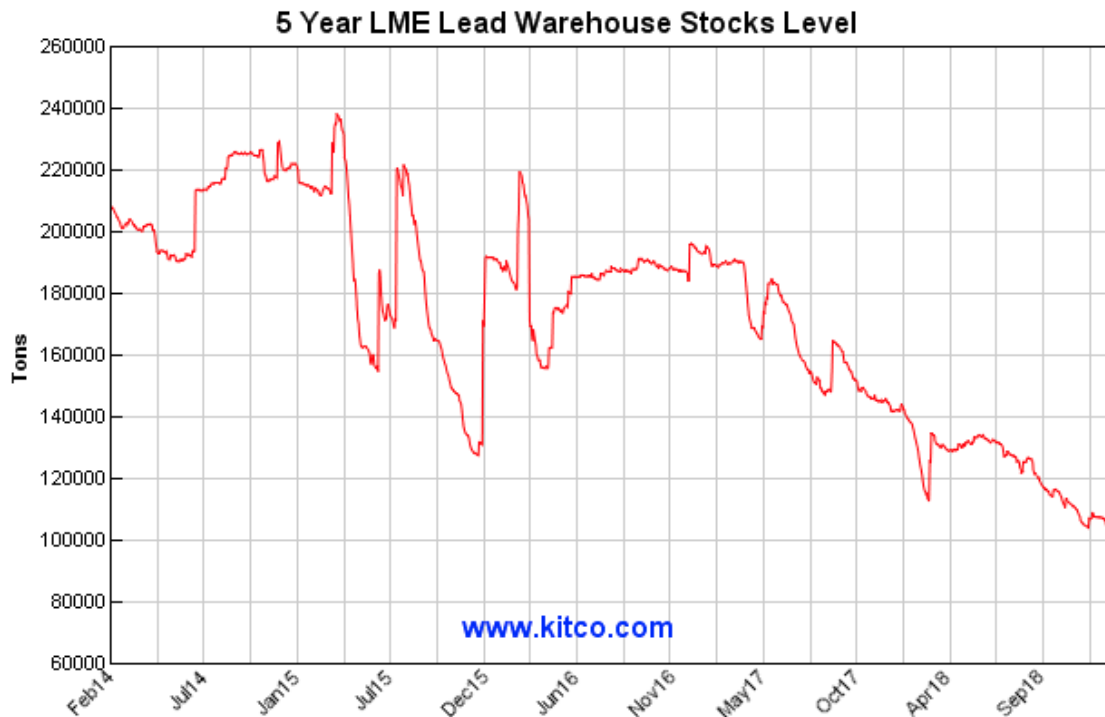
Source: Blue Ocean estimates using Company PFS assumptions – 0.73 A\$, US\$14.50/oz silver. NPV calculated at a 10% nominal discount rate

## LEAD: LME INVENTORIES AT 5 YEAR LOWS

While the lead price has retreated from its highs in part due to the rally in the US dollar, the fundamentals for lead appear relatively robust and LME inventories are sitting at 5 year lows.

In the last few weeks LME lead inventories have dropped *sharply*, suggesting to us the commodity is in deficit – see below.

In our view, this bodes well for the outlook for lead prices in CY19.



Source: Kitco, 31 Jan 2018

We remain strong believers in the mainstream adoption of Electric Vehicles (EVs) and [we were surprised to learn that Electric Vehicles still use conventional lead-acid batteries](#) (batteries have represented ~65-80% of lead demand for many years).

While lead-acid batteries are heavier, they are *much* cheaper than lithium-ion batteries and also have *much* lower rates of self-discharge. Which is one of the primary reasons EVs still use lead-acid batteries as a secondary battery system for critical elements: i.e. ignition and key safety components like lights.

## NEAR-TERM CATALYSTS

In our view the key near term de-risking milestones for Galena are:

- **Optimised PFS:** Due in early CY19 based on Dec 2018 reserve/resource upgrade
- **Definitive Feasibility Study (DFS):** A DFS for Abra is due by mid CY19
- **Debt Finance:** Galena should have debt in place by Q4 CY19 to enable construction to begin this year. Toho will assist Galena in procuring debt from Japanese export credit agencies, which typically offer debt on more attractive terms than tradition project finance (lower interest rates, longer tenor and generally less constraints)
- **Offtake agreements:** Once the deal with Toho closes, Toho will have the right to its pro-rata 40% share of the offtake for Abra. Galena will no doubt seek an offtake for its 60% share of production, and given Abra is set to produce a very high grade, high quality concentrate, we expect this offtake to be highly sought after.

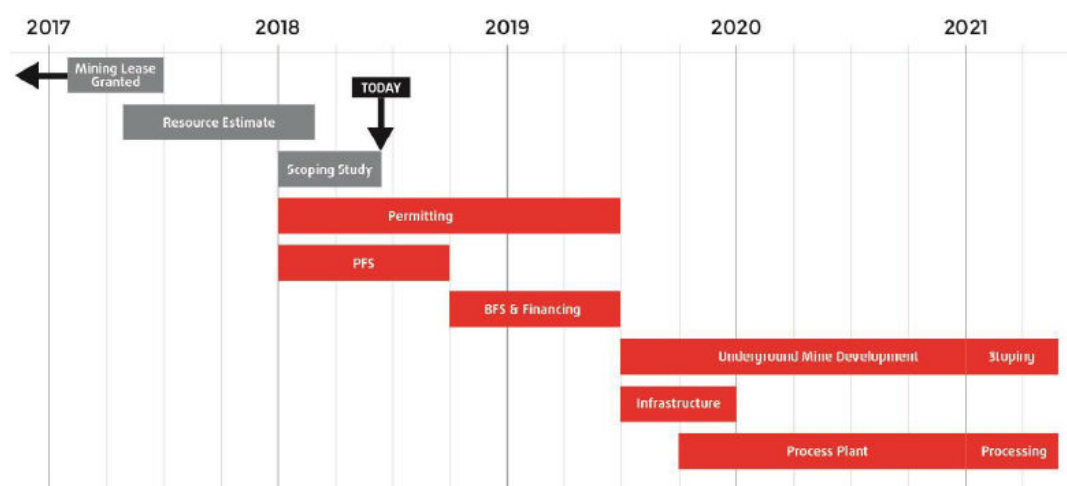
## DEVELOPMENT TIMETABLE

In addition the milestones outlined above, our forecasts assume the following development timetable for Abra:

- DFS by mid CY19
- Permits, debt and offtake in place by end Q3 CY19
- We include a 3 month buffer before construction begins
- Construction begins late CY19 / early CY20 and takes ~18 months
- First production in mid CY21

Our forecast timetable is a little more conservative than the company's target development schedule, which is set out below.

### Project Development Timetable



Source: Company

Galena sees no material impediments to meeting its target development schedule in the areas of permitting, concentrate marketing, infrastructure and logistics, or native title.

## VALUATION SENSITIVITY

Our revised NPV for Abra includes the Dec 2018 reserve resource upgrade as outlined on page 3 of this report.

The table below shows the sensitivity of our post-tax NPV for Abra at a range of lead prices and nominal discount rates. As a reminder, the spot lead price at the time of writing is ~US\$0.94/lb, but was over US\$1.20/lb in February last year.

Our forecasts assume a lead price of US\$0.95/lb and the A\$ weakens 3.7% from spot of 0.727 to 0.70.

NPV post-tax (A\$m)		Lead Price (US\$/lb)				
		0.80	0.90	1.00	1.10	1.20
<b>Discount</b>	6%	427	602	778	953	1,128
<b>Rate</b>	8%	347	496	645	794	943
<b>(nominal)</b>	10%	282	410	538	665	793
	12%	230	340	451	561	672

Source: Blue Ocean estimates. Assumes A\$/US\$ of 0.70 vs. spot of 0.727

The sensitivity table below provides our estimate of IRR post-tax for Abra at a range of lead prices.

In our view the results below are *excellent*. IRR is one of the key measures of a projects viability and typically we are looking for IRRs of 15-20% as a minimum at defensible prices, and preferably north of 25%.

To have an IRR post-tax of ~47% at spot prices is very impressive... and as the table below demonstrates, if the lead price continues to recover, the project IRRs begin to become even more impressive.

It's also probably worth noting that the lead price was >US\$1.20/lb in Feb 2018... and lead inventories are currently sitting at 5 years lows!

IRR post-tax	Lead Price (US\$/lb)				
	0.80	0.90	1.00	1.10	1.20
	36%	46%	56%	65%	75%

Source: Blue Ocean estimates. Assumes A\$/US\$ of 0.70 vs. spot of 0.727

## PRICE TARGET & RATING

We upgrade our Price Target 75% to 70c (from 40c) based on:

- The sale of a 40% stake in Abra for A\$90m to Toho Zinc
- Updating our forecasts to reflect the reserve/resource upgrade at Abra in Dec 2018 ahead of the optimised PFS due shortly. Our forecasts now reflect the lift in head grade, but exclude the potential cost savings from 13km less of lateral development flagged by the company in its reserve/resource upgrade on 17 Dec 2018.
- We have also reduced our discount to NPV from 50% to 10%, due to both:
  - the major increase in confidence the Toho transaction provides with respect to securing equity finance,
  - but also to reflect the *major* reduction in potential dilution

Our NPV<sub>10</sub> for Abra is predominately based on the PFS operating assumptions, together with essentially unchanged Blue Ocean commodity price forecasts (US\$0.95/lb lead, US\$16.00/oz silver), which are very close to spot prices (US\$0.94/lb lead, US\$16.08/lb silver).

We rate Galena a high conviction Buy and our 70c Price Target represents an implied return of over 120%.

## STRATEGIC TARGET

We derive our longer term \$1.00 Strategic Target for Galena by looking forward a few years once the A\$154m capex for Abra has been spent.

Interestingly, our current Price Target would also increase 43% to our Strategic Price Target of \$1.00, if we increase our long term lead price by 15% from US\$0.95/lb to US\$1.09/lb. For context, the spot lead price is US\$0.94/lb and hit ~US\$1.20/lb in February last year.

## KEY RISKS

Galena is exposed to all the normal risks associated with developing and operating mining projects, including permitting, native title, funding and construction risk, as well as normal project ramp up and commissioning risks.

Assuming Galena makes the transition into production, its revenues will be derived from the sale of lead concentrates (and a modest silver credit). Fluctuations in the prices of these commodities as well as the Australian dollar could impact the company's reported cash flow (in A\$), profitability and share price.

As Galena's Abra project is based in Western Australia, an investment in Galena also carries Australian sovereign risk. However, it is worth noting that Australia is considered materially lower sovereign risk than many of the other jurisdictions around the world.

Our 70c Price Target also assumes the transaction with Toho Zinc closes. The deal with Toho is subject to normal conditions, including confirmatory due diligence and FIRB approval and is expected to close in April 2019. While regard it as a low risk possibility, if transaction with Toho does not proceed, we would expect a material negative impact on Galena's share price.

**MODEL SUMMARY: FINANCIALS & VALUATION**
**Stock Details**

Recommendation:	<b>BUY</b>		
Target	\$0.70	Share Price	\$0.31
NAV	\$0.70	52 Week High	\$0.36
Implied Return	126%	52 Week Low	\$0.12

Enterprise Value	\$59m
Diluted MCap	\$120m
Diluted Shares	388m
Free Float	81%
Avg Daily Value	\$0.13m

Macro Assumptions	FY18A	FY19E	FY20E	FY21E	FY22E
Exchange Rate (A\$/US\$)	0.78	0.73	0.71	0.70	0.70
Lead Price (US\$/lb)	1.10	0.95	0.95	0.95	0.95
Silver Price (US\$/oz)	16.71	15.12	16.00	16.00	16.00

Profit & Loss (A\$m)	FY18A	FY19E	FY20E	FY21E	FY22E
Revenue	-	-	-	-	33
Operating Costs	-	-	-	-	(19)
<b>Operating Profit</b>	-	-	-	-	<b>14</b>
Corporate & Other	(1)	(4)	(4)	(4)	(5)
Exploration Expense	(0)	-	-	-	-
<b>EBITDA</b>	<b>(1)</b>	<b>(4)</b>	<b>(4)</b>	<b>(4)</b>	<b>9</b>
D&A	(0)	(0)	(0)	(0)	(1)
<b>EBIT</b>	<b>(1)</b>	<b>(4)</b>	<b>(4)</b>	<b>(4)</b>	<b>8</b>
Net Interest Expense	-	-	-	-	(6)
<b>Pre-Tax Profit</b>	<b>(1)</b>	<b>(4)</b>	<b>(4)</b>	<b>(4)</b>	<b>2</b>
Tax Expense	-	-	-	-	(1)
<b>Underlying Profit</b>	<b>(1)</b>	<b>(4)</b>	<b>(4)</b>	<b>(4)</b>	<b>2</b>
Significant Items (post tax)	-	-	-	-	-
<b>Reported Profit</b>	<b>(1)</b>	<b>(4)</b>	<b>(4)</b>	<b>(4)</b>	<b>2</b>

Cash Flow (A\$m)	FY18A	FY19E	FY20E	FY21E	FY22E
Operating Cashflow	(1)	(4)	(4)	(4)	9
Tax	-	-	-	-	(0)
Net Interest	0	-	-	-	(6)
<b>Net Operating Cash Flow</b>	<b>(1)</b>	<b>(4)</b>	<b>(4)</b>	<b>(4)</b>	<b>3</b>
Exploration	(5)	(4)	-	-	(2)
Capex	(0)	-	(31)	(62)	(1)
Acquisitions / Disposals	-	-	-	-	-
Other	(0)	-	-	-	-
<b>Net Investing Cash Flow</b>	<b>(5)</b>	<b>(4)</b>	<b>(31)</b>	<b>(62)</b>	<b>(3)</b>
Equity Issue	14	-	1	3	-
Borrowing / Repayments	-	-	-	60	-
Dividends	-	-	-	-	-
Other	-	16	42	-	-
<b>Net Financing Cash Flow</b>	<b>14</b>	<b>16</b>	<b>43</b>	<b>63</b>	<b>-</b>
Change in Cash Position	8	8	8	(3)	0
FX Adjustments	-	-	-	-	-
<b>Cash Balance</b>	<b>9</b>	<b>17</b>	<b>25</b>	<b>22</b>	<b>22</b>

Balance Sheet (A\$m)	FY18A	FY19E	FY20E	FY21E	FY22E
Cash	9	17	25	22	22
Other Current Assets	0	0	0	0	0
PP&E	0	(0)	30	92	91
Exploration & Development	9	12	12	12	15
Other Non Current Assets	-	-	-	-	-
<b>Total Assets</b>	<b>18</b>	<b>30</b>	<b>68</b>	<b>127</b>	<b>129</b>
Debt	1	1	1	61	61
Other Liabilities	0	0	0	0	0
<b>Net Assets</b>	<b>17</b>	<b>29</b>	<b>67</b>	<b>66</b>	<b>68</b>

Ratio Analysis		FY18A	FY19E	FY20E	FY21E	FY22E
Diluted Shares	m	388	388	388	388	388
EPS - Diluted	Ac	(0.4)	(1.1)	(1.1)	(1.1)	0.4
<b>P/E</b>	<b>x</b>	<b>n.m.</b>	<b>n.m.</b>	<b>n.m.</b>	<b>n.m.</b>	<b>71.7x</b>
CFPS - Diluted	Ac	(0.3)	(1.0)	(1.0)	(1.1)	0.9
<b>P/CF</b>	<b>x</b>	<b>n.m.</b>	<b>n.m.</b>	<b>n.m.</b>	<b>n.m.</b>	<b>36.1x</b>
FCF - Diluted	Ac	(0.3)	(1.0)	(9.0)	(16.9)	2.1
<b>P/FCF</b>	<b>x</b>	<b>n.m.</b>	<b>n.m.</b>	<b>n.m.</b>	<b>n.m.</b>	<b>14.6x</b>

Dividends	Ac	-	-	-	-	-
Dividend yield	%	-	-	-	-	-
Payout Ratio	%	-	-	-	-	-
Franking	%	-	-	-	-	-

Enterprise Value	A\$m	113	104	97	159	159
<b>EV/EBITDA</b>	<b>x</b>	<b>(93.1x)</b>	<b>(26.1x)</b>	<b>(24.1x)</b>	<b>(39.8x)</b>	<b>17.0x</b>
ROE	%	(7%)	(15%)	(6%)	(6%)	2%
ROA	%	(7%)	(14%)	(6%)	(3%)	1%

Net Debt / (Cash)		(8)	(16)	(24)	39	39
Gearing (ND/(ND+E))	%	(82%)	(125%)	(55%)	37%	36%
Gearing (ND/E)	%	(45%)	(56%)	(35%)	59%	57%

**Reserves & Resources (100% Basis) Updated: December 2018**

Abra Resource	mt	Pb %	Ag g/t
Measured	-	-	-
Indicated	15.0	8.7%	22.0
Inferred	22.4	6.7%	15.0
<b>Total</b>	<b>37.4</b>	<b>7.5%</b>	<b>18.0</b>

Abra Reserve	mt	Pb %	Ag g/t
Probable	10.3	8.8%	24.0

Earnings Sensitivity		FY23E	FY24E	FY23E	FY24E
		A\$m	A\$m	%	%
Lead Price	US\$/lb +10%	8	11	27%	25%
Silver Price	US\$/oz +10%	1	1	2%	2%
Exchange Rate	A\$/US\$ -10%	9	13	30%	27%

Valuation	Discount	Stake	A\$m	A\$/sh
Abra (unrisked)		60%	261	0.67
Abra (risk-adjusted)	10%	60%	235	0.60
Exploration & Projects		60%	15	0.04
Corporate & Other			(43)	(0.11)
Debt			-	-
"Effective" Cash*			61	0.16
Option Strikes			4	0.01
<b>Risk adjusted NAV</b>			<b>271</b>	<b>0.70</b>
				<b>0.44</b>

\*(1) A\$3.3m in cash at end Dec 2018 + (2) \$10m from Toho + (3) 60% share of \$80m in JV with Toho. (2) & (3) subject to transaction close and meeting conditions



**MODEL SUMMARY: OPERATIONAL INPUTS & FREE CASH FLOW**

Operational Summary		FY18A	FY19E	FY20E	FY21E	FY22E
<b>Abra (100% Basis)</b>						
Ore Mined	mt	-	-	-	-	0.23
Mill Throughput	mt	-	-	-	-	0.23
Lead Head Grade	%	-	-	-	-	8.2%
Lead Recovery	%	-	-	-	-	96%
<b>Lead-in-conc Produced</b>	<b>kt</b>	-	-	-	-	<b>18</b>
<b>Group (60% Basis)</b>						
<b>Lead-in-conc Produced</b>	<b>kt</b>	-	-	-	-	<b>11</b>
C1 Cost (post credits)	A\$/lb Pb	-	-	-	-	0.62
Royalties	A\$/lb Pb	-	-	-	-	0.11
Sustaining Capex	A\$/lb Pb	-	-	-	-	0.03
<b>All-in Sustaining Cost</b>	<b>A\$/lb Pb</b>	-	-	-	-	<b>0.76</b>
All-in Sustaining Cost	US\$/lb Pb	-	-	-	-	0.53

Macro Assumptions		FY18A	FY19E	FY20E	FY21E	FY22E
A\$ Exchange Rate	A\$/US\$	0.78	0.73	0.71	0.70	0.70
Lead Price	US\$/lb	1.10	0.95	0.95	0.95	0.95
Silver Price	US\$/oz	16.71	15.12	16.00	16.00	16.00
Lead Price Realised	A\$/lb	1.42	1.30	1.34	1.36	1.36
Silver Price Realised	A\$/oz	21.55	20.79	22.54	22.86	22.86

Abra (60% Basis)	A\$m	FY18A	FY19E	FY20E	FY21E	FY22E
Lead Revenue		-	-	-	-	31
C1 Cost (post credits)		-	-	-	-	14
Royalties		-	-	-	-	2
Sustaining Capex		-	-	-	-	1
All-in Sustaining Cost		-	-	-	-	17
<b>All-in Sustaining Margin</b>		-	-	-	-	<b>14</b>
Growth Capex		0	-	31	62	-
Exploration		5	4	-	-	2
<b>All-in Margin</b>		<b>(5)</b>	<b>(4)</b>	<b>(31)</b>	<b>(62)</b>	<b>11</b>
<b>Corporate</b>						
Cash Tax	A\$m	-	-	-	-	0
Corporate & Other		1	(12)	(38)	4	5
<b>FCF pre Debt Service</b>		<b>(6)</b>	<b>8</b>	<b>7</b>	<b>(66)</b>	<b>6</b>
Net Interest		(0)	-	-	-	6
Debt Drawdown / (Repayment)		-	-	-	60	-
<b>FCF post Debt Service</b>		<b>(6)</b>	<b>8</b>	<b>7</b>	<b>(6)</b>	<b>0</b>
<b>New Equity/Dividends</b>						
Proceeds from Shares/Options	A\$m	14	-	1	3	-
Dividends Paid		-	-	-	-	-
<b>Change in Cash</b>		<b>8</b>	<b>8</b>	<b>8</b>	<b>(3)</b>	<b>0</b>
<b>Cash Balance</b>		<b>9</b>	<b>17</b>	<b>25</b>	<b>22</b>	<b>22</b>

Source: Company data, Blue Ocean Equities

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Steuart McIntyre does not own shares in Galena Mining.