

Stonewall Resources (SWJ)

Set for a turn around

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KEY POINTS

- Stonewall Resources (SWJ) has significant gold resources of 3.72Moz supported by existing infrastructure, in a proven mining district. A recent change in focus to target shallow high grade, open pitable, from the previous focus of underground operations provides SWJ with an additional development path.
- Over the past couple of years SWJ performance has been hampered by; a lack of funding, debt and a failed takeover bid. We see that planned conversion of the debt and recent capital raisings as providing a new growth platform.
- We initiate with a Speculative Buy recommendation and Very High risk rating

Significant Gold Resources

Stonewall Resources Limited (ASX:SWJ) is a gold developer with a 3.72Moz at a grade of 4.34g/t gold. The assets are located in the historic Sabie-Pilgram's Rest Goldfields mining region of South Africa (~340km NE of Johannesburg). Production from the area dates back to the late 1800's through to 2010, with ~7Moz of gold produced at an average grade of ~10g/t. The gold occurs as predominantly relatively flat lying quartz reefs.

From 2011 to 2015 SWJ undertook small scale production from remnant ore and reprocessing of tails. In 2013 the sale of the South African assets for US\$141m was announced. The sale was not completed, resulting in protracted legal arguments. The case was successfully concluded this year (compensation payment still pending) allowing the focus to revert back on the aim of becoming a low cost gold producer.

The recent exploration work undertaken by SWJ has added more high grade ounces to the inventory, with more additions likely. Importantly a good component of these ounces are located close to the surface, which could be potentially mined from an open cut pit, complementing the two existing prioritised underground resources.

Existing infrastructure includes a conventional CIL plant, which provides SWJ with a head start in permitting, construction time and reduced capital costs.

A scoping study completed in May 2017 was based on the development of two underground mines and total production of 90,000oz pa at an All In Sustaining Cost of US\$624/oz.

A PFS is currently underway and due for completion in mid-2018. Subject to project financing the plant refurbishment is due to commence in 2H 2018.

RECOMMENDATION

Speculative Buy

Previous Recommendation	Initiation
Risk Rating	Very High
Current Share Price	\$0.02
12 Month Price Target	NA
Shares on Issue (m)	2,250
Options Listed (m)	147
Options Unlisted (m)	29
Diluted Market Capital	\$43.2m
Cash (A\$m) (PAC estimate)	\$1m
Debt (A\$m) (PAC estimate)	\$6.5m

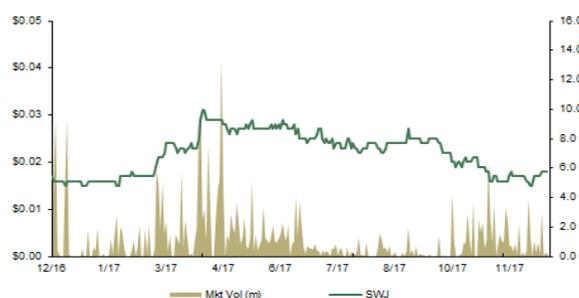
Investment Summary

With an expanded resource base, good grades and exploration upside SWJ is in a good position to attract the attention of not only equity investors but also as a possible M&A target. .

With 3.7Moz of gold at a good grade, an existing plant, strong drilling results and a target of becoming a 100,000oz pa producer the only limitation for SWJ is the balance sheet needed to fast track the project. The restructuring of the capital structure, in particular the debt facilities, will be important to make SWJ a more compelling investment decision.

SWJ has made significant advancements at the project level over the past 12 months and is now nearing completion of the corporate turnaround. With a target of potentially commencing refurbishment of the existing mill in late 2018 and news flow around exploration and resource expansion the time is looking good for SWJ.

SWJ Share price performance



Source: Iress

Projects Overview – TGME Project Area

SWJ's main focus is the TGME Project, which is situated within the historical Sabie-Pilgrim's Rest Goldfield. The Sabie-Pilgrim's Rest Goldfield is one of South Africa's oldest gold mining districts with historical production estimated at 180-200 tonnes of gold (6Moz). The Field is located approximately 340km NE of Johannesburg.

The TGME Project is split into two project areas, with the Pilgrims Rest Mines in the north and Sabie Mines located in the south of the project area, approximately 40km apart on the State highway. The tenement package includes over 40 historic mine sites.

Prior to SWJ acquiring the land package it was held by Rand Mining for a number of years during the 1980's to late 1990's, during this time Rand's focus was on other gold projects and also uranium projects.

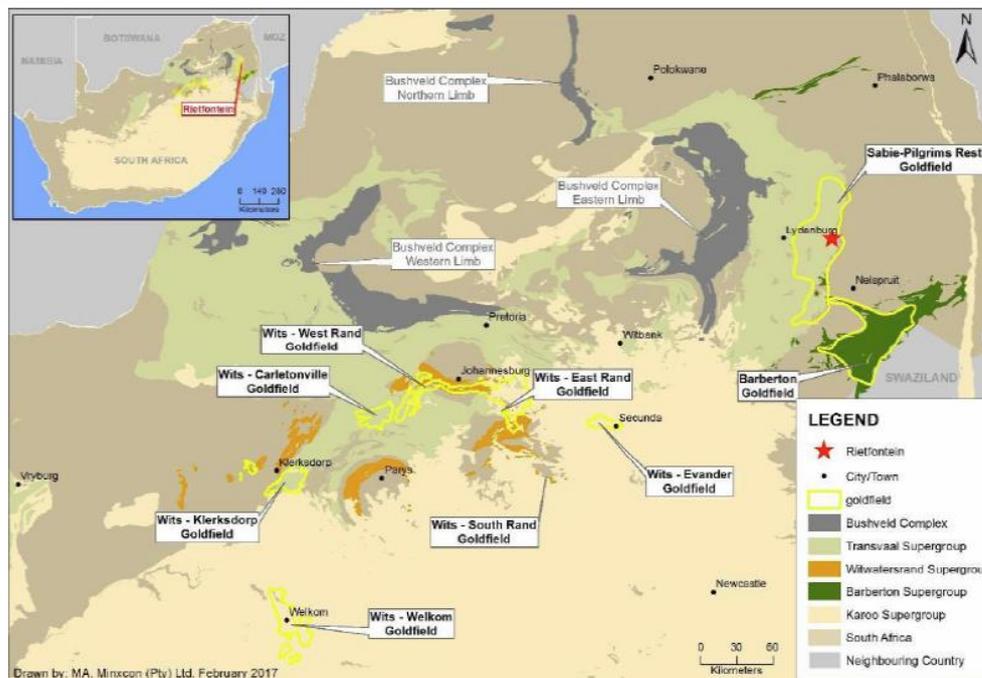
New direction – Drilling to firm up the targeted shallow gold.

SWJ first entered into an agreement to purchase the assets in 2010 and then listed on the ASX in April 2011. Initially the company commenced small scale production from existing mine dumps and tailing facilities. Following a series of board & management changes from mid-2015, the direction taken has been to undertake extensive exploration which has resulted in upgrading the resource from 2.99Moz to 3.72Moz gold.

In addition to the resource expansion a review of historical data identified a number high grade shallow reef structures that had not been fully explored. This has opened up an opportunity to look at potential open cut operations.

Location of the Sabie-Pilgrims Rest Goldfield

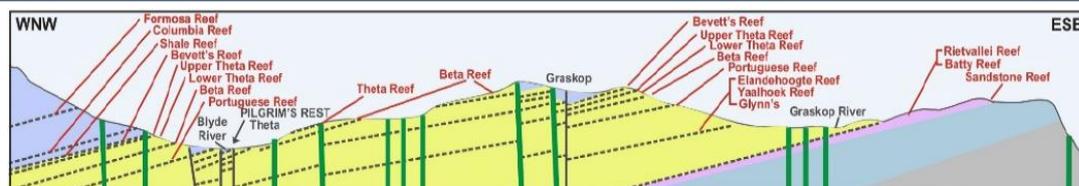
Project area in a known mineralised area with significant historic high grade gold production, both shallow underground stope mining (no shafts required).



Source: Company Report

The gold mineralisation in the field is typically epigenetic, occurring as concordant and discordant veins in a variety of host rocks. Flat reef or layer parallel veins are the principle source of gold mineralisation.

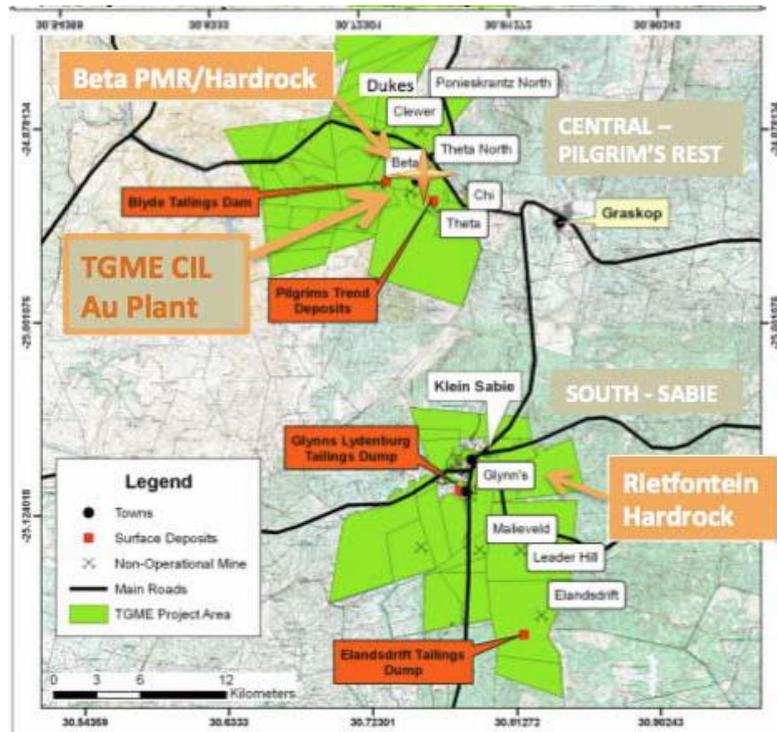
Geology Cross Section –Highlighting Reef Structures



Source: Company Report

Tenement Map of SWJ's Project Areas

Production plan is for the TGME Plant to process ore from the Rietfontein Mine (40kms to the south) and in addition commence mining from the Beta Mine.



Source: Company Report

TGME PANT

The TGME plant is a conventional CIL circuit, that was constructed in 1984 by Rand Mines. Historically it was built to treat the existing waste dumps with a nameplate capacity of 150,000tpa, with the crushing circuit the current constraint on the plant. SWJ has based the scoping study on increasing this to 250,000tpa. The TGME plant operated was used by SWJ between 2011 to 2015, producing ~6,000 ounces of gold in what was more a testing phase.

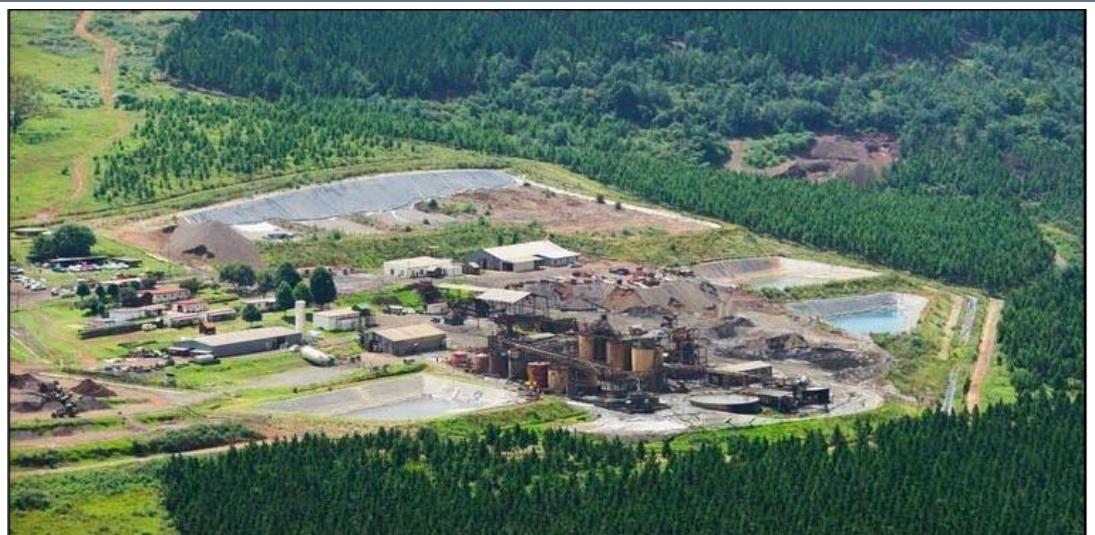
In the current form the plant would be able to process the oxide ore that is being targeted. At this stage there is no plans to modify the plant to be able to treat refractory ore.

Retreating tails could be a low cost option for SWJ

When SWJ commenced production it was by reprocessing the TGME tails dam, however the tails dam was never systematically drill tested and presents an opportunity for SWJ. A total of 34 holes have been completed on the dam, the results are pending. The possibility is to use the material to speed the ramp up process when production resumes.

Aerial view of the TGME processing plant and tailings dam

The existing plant and associated infrastructure is a significant advantage for SWJ



Source: Company Report

Rietfontein is planned to be SWJ's first underground mine.

RIETFONTein MINE

As part of the mine reopening program SWJ has commenced underground exploration at the Rietfontein Mine. The reconnaissance work so far has shown that the condition of the underground workings remains good despite the mine closing in the 1950's. Following the mine closure there has been limited exploration undertaken at Rietfontein, this represents a large upside potential for SWJ. More drilling is planned at Rietfontein in early 2018, initially from surface, followed by later underground drilling, where appropriate.

The trucking distance to TGME is 35km on exiting highways. With a grade of ~10g/t and a relatively short distance the economics of a trucking operation appear positive. The results of the PFS will provide a better view on the project economics.

Closer to the plant but lower grade

BETA MINE

The Beta Mine is located only 2km from the TGME Plant. With a total resource of just over 1.0Moz gold at an average grade of 6g/t and in close proximity to the existing plant the Beta deposit provides SWJ with a good development opportunity. The mine was last operated in the early 2000's. This is the second underground mine that SWJ plans to bring online. Despite the closer proximity of Beta to the TGME plant we see the decision to open up the higher grade Rietfontein Mine as prudent.

High grade shallow gold hits

PROJECT BENTLEY

In addition to the two underground mine developments at Beta and Rietfontein SWJ has embarked on a strategy to develop shallow open cut operations in parallel with the underground developments.

SWJ has identified a number of shallow multiple stacked reefs in historic data and has undertaken a drilling program at the Hills and Columbia Hills prospects. A total of 11 drill holes were completed for 544m at Theta Hills. The drilling targeted 4 different reefs.

Recently the first of the assays were reported from the Theta drilling, with highlights including:

- 2m @ 16.5g/t gold from 25m
- 16m @ 2.0g/t gold from 22m),
- 5m @ 6.0g/t gold (including 2m @ 8.9g/t gold) from 11m

In addition to the Theta prospect SWJ has also identified additional shallow high grade reefs that they plan to drill test in early 2018. Recent results from Columbia Hills included a number of high grade hits over mineable widths.

In addition to the 3.72Moz SWJ has announced an exploration target of ~680koz – 1.86Moz

Resources

Across the TGME Project Area a resource of 3.72Moz gold has been reported. This is across underground resources and tails facilities.

	Tonnes (Mt)	Gold grade (g/t)	Gold (oz)
Rietfontein	22.0	10.8	905,000
Beta	8.5	6.5	1,003,100
Project Total	26.7	4.3	3,720,000

Source: Company Report and PAC Partners estimates

Legal Settlement

Following the failure of proposed sale of SWJ's South African assets in 2013 to the Chinese company, Shandong Qixing Iron Tower Co. Ltd ("Shandong"), SWJ took legal action against Shandong. In 2017 the case was awarded to SWJ with the determination that::

- Shandong is to pay Stonewall US\$12.6 million; plus
- Interest on that amount at 8%, compounded quarterly, commencing 1 January 2015 until paid (US\$2,838,880 as at 24 July 2017); plus
- Shandong is to pay Stonewall's legal costs of A\$1,498,678; plus
- Interest on Stonewall's legal costs at 8%, compounded quarterly, commencing 1 September 2016 until paid (A\$105,732 as at 24 July 2017); plus
- Shandong is to bear 100% of the Tribunal's costs of HK\$1,899,765.25; plus
- Shandong to bear 100% of the HKIAC's administration costs of HK\$407,961.99

To date the funds have not been paid to SWJ, in an effort to retrieve the funds owed SWJ has engaged a firm that will receive 45% of monies recovered.

Whilst the amount of money due to SWJ is significant we see that the issues surrounded with recovering money from a Chinese based company as difficult therefore we have not assumed the funds will be recovered in the near term in our assessment of the company.

Capital Raising

Recent capital raisings include:

June 2017 placement to raise \$2.09m at \$0.025/sh

October 2017 placement to raise \$2.5m @ \$0.019/sh, plus associated SPP for \$162,000.

A shortfall of up to ~\$6m can be allocated from the SPP.

Cash and Debt Position

Cash ~\$1.0m (PAC estimate). Following the recent capital raising the company has been actively drilling therefore we estimate that the cash position has been lowered.

PAC estimate the total debt at ~A\$7.5m, this consist of:

- A\$1.65m – convertible note held by a significant shareholder (held by major shareholder Tasman Funds and shall only convert into shares)
- A\$5.0m loan to a related party of the major shareholder. This facility is fully drawn and attracting no additional interest charges, to date at least 1/3 is converted into shares at market price and balance repaid only following Arbitration award payment received or from production.
- \$1.0m remaining of a facility that partially converts at \$0.019/sh every month.

The overhang of the debt position is likely to weigh on the stock until the payment or conversion to equity.

Risks

Metallurgy: whilst the properties of the oxide ore are relatively well known from historic operations the probability of refractory ore existing needs to be understood.

Country Risk: the projects are situated in South Africa, which has an active mining industry and a long mining history but the risk of potential policy change does need to be acknowledged.

Geology variability: The nature of gold mineralisation is subject to geological variations that could fall outside of the scope of testing methods used.

Regularity Approvals: Additional permitting will be required to bring the operations back online.

Project Financing: With limited cash additional capital rasings will be required to fund exploration and development of the project. This financing is likely to be a mix of debt and equity funding.

Debt Servicing: The company currently has drawn down on debt facilities, with no operating cash flow the ability to service these loans is unclear.

Board and Management

Rob Thomson
Managing Director

Rob Thomson was appointed as Managing Director in November 2016, has previously had key roles in taking 8 exploration projects through to mining operations. These include Finder's Wetar copper cathode project in Indonesia, Kingsgate's Chatree open-cut gold mine in Thailand, Oxiana's Sepon open-cut CIL gold mine in Laos, and Climax Mining's Didipio gold/copper project in the Philippines. Rob started his career in underground gold mining in Southern Africa more than a few decades ago and went on to successful roles as CEO; executive director and director. He holds a Bachelor of Engineering from the University of Queensland and a Master in Business Administration from the University of Wollongong..

Trevor Fourie
Non-executive director / chairman

Trevor has more than 15 years of resource and mining industry experience as well as 24 years of experience in corporate and retail banking with Barclays Bank and First National Bank. Trevor was formerly a non-executive director of Galaxy Gold, an executive director of FBC Future Bank and marketing director for WesBank, a division of FirstRand Bank. He was previously chief executive officer of the leasing division at RMB Australia and executive director of RMB Australia (Rand Merchant Bank Australia).

Bill Richie Yang
Non-executive director

Richie has more than 10 years of corporate finance experience working with public and private companies, assisting them with capital raising and corporate structures. Richie previously held executive positions for various public companies developing iron ore and gold assets where he successfully managed in-house teams and external contractors in completing scoping and feasibility studies for various Australian mining projects.

Simon Liu
Non-executive director

Simon is a founding partner and president of Hanhong Private Equity Investment Company. He graduated from the School of Journalism and Communication at Renmin University in China. He has more than 20 years of experience in the marketing and consulting industry.

Dr Eric Zhang
Non-executive director

Eric has worked in investment project, financial analysis and policy analysis in Australia and Asia for more than 10 years. He has experiences across financial institutions, government agencies and education sections. Eric is the chief executive officer and a director of Tasman Funds Management Pty Ltd, a Sydney–China based funds management company.

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RECOMMENDATION CRITERIA

Investment View

PAC Partners Investment View is based on an absolute 1-year total return equal to capital appreciation plus yield.

A Speculative recommendation is when a company has limited experience from which to derive a fundamental investment view.

Buy	Hold	Sell
>20%	20% – 5%	<5%

Risk Rating

PAC Partners has a four tier Risk Rating System consisting of: Very High, High, Medium and Low. The Risk Rating is a subjective rating based on: Management Track Record, Forecasting Risk, Industry Risk and Financial Risk including cash flow analysis.

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